

**Equal Treatment of Foreign Shareholders in Transnational Securities
Class Action against a Foreign Issuer—a Chinese Example**

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I. Introduction

As the world economy and financial markets become increasingly more integrated, cross-boarder securities transaction becomes a daily event. Because United States has the world’s largest and arguably most liquid capital markets, it has attracted a significant number of foreign companies to cross-list their stocks in a U.S. stock exchange. Unavoidably, such transactions will not only bring out fortune, but also disputes between transacting parties. Relying on the powerful federal securities law,¹ U.S. investors who

have bought or sold such stocks have routinely sued foreign stock issuers through class action when the stock prices went down, alleging their loss is caused by the issuer's misdeeds, such as a failure to disclose material financial information.² Although such misdeeds, if established, usually affect both U.S. investors and their foreign counterparts, the latter could easily be dismissed by federal courts on jurisdiction or legal standing grounds when they try to join the action.³

In order to show the existence of subject matter jurisdiction, foreign investors who have transacted in the stocks need to pass one or both of the two jurisdictional tests developed by federal courts.⁴ The “conduct” test is based on fraudulent conduct that took place within the United States, even though “the allegedly fraudulent transactions involved foreign investors, foreign sellers, or foreign securities.”⁵ The other is called “effects” test, which requires subject matter jurisdiction be based on an adverse effects on American investors despite the foreign involvement in the allegedly fraudulent transactions.⁶ The determination of subject matter jurisdiction is “a very fact-intensive exercise,” and foreign investors could be denied the access to a federal court due to factual variations.⁷ Moreover, if a class action is particularly brought under section 11 of the Securities Act or section 9(e) of the Exchange Act, foreign investors may be excluded for another reason—their shares may have been bought from a foreign exchange and therefore, they cannot satisfy the registration requirement under these two sections.⁸

Excluding foreign investors from securities class action while entertaining American investors' actions is unfair because the foreign investors may not only be denied the same protection, but also be forced to pay for the loss of their American counterparts when the assets of their company are used to pay for the judgment rendered

by federal courts. This discrepant treatment of shareholders based on residence arises because the federal substantive and procedural law may make it easier for investors to receive compensation in the U.S. than in the issuer's home country, even when the underlying claim is the same. Such a prospect is especially possible if the level of investor protection in the issuer's home country, such as China, is much less than that usually found in developed economies, such as United States. In 2002, the Supreme People's Court of China issued *Several Regulations Concerning the Adjudication of Civil Compensation of Securities Cases Based upon Misrepresentation* (to be called *Several Regulations*, supra).⁹ Although this regulation would for the first time allow the Chinese courts to accept private law suits based on misrepresentation¹⁰, it has laid down some substantial procedural limitations on a defrauded investor right to sue an issuer for misdeeds.

The author believes that the current judicial interpretation of the extra-territorial application of the federal securities law is against the *equal treatment principle* of the traditional corporate law. Such unequal treatment is not justified because the affected foreign shareholders did not bargain for such an arrangement. Moreover, the unequal treatment will degrade the market integrity and will hurt the U.S. interests in the longer run. Therefore, the Court and the legislators should consider making adjustment to the current approach towards such litigations. Possible solutions may include extending subject matter jurisdiction to foreign investors, through a contractual arrangement where transacting parties could negotiate a dispute resolution regardless of the scope of the transaction, or through a reciprocal treaty arrangement so the applicable forum and law could be uniform for all investors involved.

II. Unequal Treatment of Foreign Shareholders under Current Legal Scheme

To understand the effects of the United States' discriminatory treatment of foreign plaintiffs in the context of securities class actions, it is necessary to appreciate the differences that inhere in the securities regulatory schemes between United States and other countries. This part will mainly discuss the legislative and judicial development of the extraterritorial application of the federal securities law, and the possible negative effects under the current approach. Part III will use China as an example to illustrate the points made here.

A. Private Right of Action under Federal Securities Law

Both Securities Act of 1933 and Exchange Act of 1934 grant private rights of actions against an issuer due to its misdeeds. Most important of such rights include sections 11, 12(a)(2) of the Securities Act of 1933, and sections 9(e), 18 of the Securities Exchange Act of 1934.¹¹ In addition, courts have also developed an implied private right of action from section 10 of the Exchange Act of 1934 and the SEC Rule 10b-5.¹² The reason that an issuer is given particular attention here is that a U.S. court can force a foreign shareholder to pay for the loss of American one only if the defendant in the class action is the issuer.¹³ As we will see, whether such shareholders can be included in a class action does not depend on whether they are innocent, nor on whether they have suffered similarly from the alleged misdeeds of the issuer.

Section 11 of the 1933 Act gives an express cause of action for any “untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading,”¹⁴ it limits the availability of such an action to the purchasers (instead of both seller and purchaser) of the security only; and only if such securities are sold under a registration statement filed with SEC.¹⁵ Therefore, in case of a double-listing, a foreign investor will not have the same remedy as an American investor if he buys from a foreign exchange because his shares are not subject to the registration requirements,¹⁶ even if he has suffered loss due to the same false disclosure as the American investor. Similarly, a foreign investor who bought a double-listed company’s shares in a foreign exchange cannot rely on section 9(e) of the 1934 Act, which provides a civil remedy to any person who buys or sells a security at a price affected by specified activities designed to manipulate the price of any security *registered on a national exchange*.¹⁷

If a class action is brought under section 12(a)(2) (of the Securities Act), section 18 (of the Exchange Act), or the implied right of action based on section 10b or rule 10b-5, foreign plaintiffs can be included in class action if their claims satisfy the subject matter jurisdiction requirement of the federal securities law. The interpretation of such requirement in turn depends on courts’ understanding of the scope of the extra-territorial application of federal securities law. Unfortunately, federal courts have not considered the foreign investors’ possible loss as relevant to their decisions.

B. Courts' Interpretation of the Extra-Territorial Application of Federal Securities Law

The extraterritorial application of federal economic law first appeared in antitrust cases under Sherman Act.¹⁸ Learned Hand in *United States v. Aluminum Company of America* reasoned that

[T]he only question open [before a court] is whether Congress intended to impose the liability, and whether our own Constitution permitted it to do so: as a court of the United States, we cannot look beyond our own law. Nevertheless, it is quite true that we are not to read general words, such as those in this Act, without regard to the limitations customarily observed by nations upon the exercise of their powers; limitations which generally correspond to those fixed by the 'Conflict of Laws.' ... On the other hand, it is settled law- as 'Limited' itself agrees- that any state may impose liabilities, even upon persons not within its allegiance, for conduct outside its borders that has consequences within its borders which the state reprehends; and these liabilities other states will ordinarily recognize. 148 F.2d at 443.

Because "Alcoa's assertion has been roundly disputed by many foreign commentators as being in conflict with international law, comity, and good judgment[,]"¹⁹ some other circuits did not follow strictly ALCOA, but instead stressed in applying domestic law on foreign entities, it may be necessary to consider the conflicting interests of a foreign nation.²⁰ For example, the Ninth Circuit reasoned that

The effects test by itself is incomplete because it fails to consider other nations interests... [T]he test which determines whether United States law is applicable must focus on *the nexus between the parties and their practices and the United States*, not on the mechanical circumstances of effect on commodity exports or imports.

American courts have, in fact, often displayed a regard for comity and the prerogatives of other nations and considered their interests as well as other parts of the factual circumstances, even when professing to apply an effects test. To some degree, the requirement for a “substantial” effect may silently incorporate these additional considerations, with “substantial” as a flexible standard that varies with other factors.²¹ [stress added]

The “effects” and “conduct” tests used by courts in securities litigation followed the same analysis.²² The effects test requires a court to determine whether misdeeds have a “substantial adverse effect” that has affected specific investors or other entities in the United States. The conduct test developed from the recognition that “Congress does not want ‘the United States to be used as a base for manufacturing fraudulent security device for export, even when these are peddled only to foreigners.’”²³ Some courts may use a mixture of the two—for e.g., the Second Circuit has held in Bersch v. Drexel Firststone, “the effects and conduct tests need ‘not be applied separately and distinctly from each other’ and that, in fact, ‘an admixture or combination of the two often gives a better picture of whether there is sufficient United States involvement to justify the exercise of jurisdiction by an American court.’”²⁴ Therefore, the anti-fraud provisions of the federal securities laws

- (1) Apply to losses from sales of securities to Americans resident in the United States whether or not acts (or culpable failures to act) of material importance occurred in this country; and
- (2) Apply to losses from sales of securities to Americans resident abroad if, but only if, acts (or culpable failures to act) of material importance in the United States have significantly contributed thereto; but
- (3) Do not apply to losses from sales of securities to foreigners outside the United States unless acts (or culpable failures to act) within the United States directly caused such losses.²⁵

Using such a test, the Second Circuit in *Bersch* decided to eliminate from the class all purchasers other than persons who were residents or citizens of the United States because the alleged fraudulent conduct mainly happened outside of United States; although certain actions related to the alleged fraud were committed in the U.S., they were merely preparatory and would not satisfy the conduct test for those foreign shareholders affected by the alleged fraudulent actions. Thus, courts have limited the reach of either test by requiring a strong nexus of the acts and the parties involved (in conduct test),²⁶ or a sufficient U.S. interest in entertaining the underlying complaints (in effects test).²⁷ Therefore, regardless of the tests used, there is always a danger to the foreign investors' claim against foreign issuers because the "connection" between their claim and the United States is deemed too insignificant, even though they may have suffered loss due to the same reason as American investors.²⁸

C. Harm of Eliminating Foreign Investors from Securities Class Action

Eliminating the foreign investors from securities class action based on jurisdiction deficiency is not a sound policy choice. First, in so ruling, the courts will be forcing the at least equally innocent investors to pay for the loss of their American counterparts.

Although federal securities law does not have comprehensive requirements that shareholders be treated equally in all aspects, it does require equal treatment be applied in certain areas. For example, the "best price rule" requires a company making a tender offer to pay all tendering shareholders the same price for their shares.²⁹ In addition, the interpretation of the antifraud provision by courts have never indicated that foreign investors should be treated less favorably either. Moreover, traditional corporate law also require all shareholders be treated equally in most aspects, such as tender offer, profit distribution; if occasionally equal treatment is not possible,³⁰ corporate law requires shareholders be treated fairly—which means that at least a corporate board had a fiduciary duty (all other things being equal) to ensure that all stockholders were treated alike and that no one stockholder received a benefit at the cost of another.³¹ Although such an obligation of equal treatment usually falls upon dominant shareholders or a board of directors, rejecting a class certification where foreign investors have been included will undermine this long-standing principle in state corporate law. Neither does the language of the federal securities law require courts to interpret its extraterritorial reach in such a way as to override this principle and such a drastic change cannot be implied from the statute without Congress express intention.³²

Even if courts stick to the conduct-effects scheme, courts should still grant subject matter jurisdiction to foreign investors because the fast-advancing communications technology makes fraud-on-the-market theory increasingly more real. Although this theory has been rejected by the D.C. District in *In re Baan Co. Securities Litigation*, in which the court held that “employing that [fraud on the market] doctrine to fulfill the requirements of the conduct test would extend the reach of the 1934 too far[,]”³³ courts should reconsider such a proposal due to the changing securities transaction environment.

Second, denying foreign investors’ claim based on jurisdiction in securities class actions may also have the negative consequence of deterring foreign companies from entering the US capital markets and thus depriving the American investors an opportunity to diversify their portfolios. Although US capital markets may still be the most liquid one in the world, the integration of the world economy and financial markets has pushed many other international exchanges to adopt reforms to lower their cost and increase their service level for their international clients. For example, both London Stock Exchange and Hong Kong Stock Exchange have actively seeking foreign companies and changed their listing rules to be more favorable to foreign issuers.³⁴ Preventing plaintiffs to be added in securities class actions will not decrease the *chances* of being sued in a US court. On the contrary, foreign investors will at least get some assurance that they will be not ripped off by US legal system if they know they are protected the same way as their American counterparts. This assurance may encourage foreign shareholders to support a management plan to make a public offering in the United States. However, a possible concurrent effect would be that if any violation is found on the part of an issuer, the possible liability will increase if foreign investors are also included, which may deter a

management team from going abroad in the first place. What is the net effect of the two factors? This may require some empirical evidence—but I guess the unequal treatment is a more realistic threat than a possible larger damage to be granted by the court because after all, the former is an institutionalized discrimination while the latter is the result of equal application of securities law. Hence, disallowing foreign investors in securities class action may lower the attractiveness of the US capital markets in the long run.

Courts treatment of foreign investors are not very sound also for practical reasons. First, courts' concern about the limited judicial resources when foreign investors are involved is not very reasonable because adding them to the class that has already been formed by American residents will not significantly increase the cost to the already expensive litigation—most discovery, which may include anything that is related to the alleged misdeeds, will be conducted regardless of whether such investors are included in the class or not.

Second, the less favorable treatment of foreign investor cannot be justified by the argument that an issuer has chosen to accept such a result when it decides to go abroad. One problem of this reasoning is that the foreign investors did not make such choice—although there may be a shareholders approval requirement for any decision to go listing overseas, the power imbalance between the management and the minority shareholders will often make such safeguard more nominal than real.³⁵ Moreover, the fact-intensive determination jurisdiction has made any risk-adjustment in advance on the part of investors very difficult to quantify—should foreign shareholders expect that they will not be treated less favorably because their reside outside of United States? (Don't people say U.S. has the most stringent investor protection regulation in the world?) Even if the

answer is yes, how much premium can one investor expect to receive in order to vote for a listing in the United States?

Third, the *res judicata* concern courts sometimes used to defend its refusal to entertain foreign investors' claims is not defensible either. Such concern is raised because courts do not want to spend time and money to entertain a case if the losing party can always relitigate it in his home country again.³⁶ However, since our attention here is the unequal treatment of shareholders from countries with much less protection than the United States, it is not too risky to assume that such concern may not materialize after all despite of the fact that civil law countries' *res judicata* doctrine is much narrower in scope than its common law counterpart. The more probable cause for concern in judicial cooperation in our case is whether a foreign court would likely enforce a favorable judgment for the defendant by a US court.³⁷ Nevertheless, because such litigation will predominantly involve foreign companies listed in the United States, the fear that they can be immune from unfavorable judgment is not very realistic.

III. Private Securities Litigation in China

To illustrate the effects of different treatment of foreign investors, one just needs to turn to China because its securities market has a very short history and one would reasonably assume that it has a weak investor protection. Indeed, in China, an investor's rights to sue an issuer for misdeeds are limited to those specified in *Several Regulations* issued by the Supreme People's Court in 2003.³⁸ They differ from those available to an U.S. investor, both substantively and procedurally, in the following several aspects:

- 1) Investors may bring civil action only for misrepresentation of information – but not for insider trading or market manipulation.
- 2) Courts are allowed to hear cases, but only after the CSRC had investigated them and had found wrongdoing. Such a requirement may give CSRC an incentive to issue a “warning” instead of a misdeed determination in order to discipline issuers—although CSRC also has strong incentive to maintain the market integrity, the fact that the majority of the publicly traded companies in China are controlled by the state may cause CSRC think twice before it takes such severe action to punish wrongdoers.
- 3) Cases are subject to a two-year statutory limitation, running from the CSRC's determination of any wrongdoing.
- 4) Collective actions are allowed for private litigation, but not class actions.

Therefore, unless one has opted in before the litigation starts, he cannot expect to receive any compensation as he would in a class action.

- 5) A court's (personal) jurisdiction over such claims is limited to where the issuer is located—because of the interrelationship between government and enterprises, and that between government and courts, there may be a strong local bias against such private law suits.
- 6) Law suits are not allowed in private transactions or transaction conducted outside of the state-approved securities markets. This means neither private transactions, nor transactions conducted in a foreign country, will be protected under this new rule.
- 7) Courts shall deny causal relationship between false disclosure and investor losses when he buys a security prior to the false disclosure or sells a security before the falsity of disclosure is publicly revealed. Thus, an investor cannot bring a suit even if he suffered losses because he *sold* his security at a price lower than it could be if the issuer had disclosed the hidden good news.³⁹

All such requirements may have contributed to the Chinese investors' difficulties to obtain favorable judgments from the issuers.⁴⁰ This should be of no concern to legal scholars if the effects of such regulation are limited to China. However, with more and more U.S. investors, both private and institutional, prepared to make equity investment in Chinese companies,⁴¹ the American legal system has to answer the question whether excluding foreign investors based on the current jurisdiction analysis by courts benefits the country in the long run.

But why would the Chinese government have such a kind of rule? Isn't this kind of investor protection ostensibly inadequate? Before we accuse the Chinese government

for their “failure,” a little history of China’s economic and financial market reform will help us to understand maybe its adopted policy is not so “unreasonable” as it seems in the first place and may point out some solutions for the future. Moreover, China is just one example of the much larger problem caused by the differences existing in the world’s different legal systems. Such differences not only create different “classes” of shareholder but also enable some shareholder’s oppression of others. Therefore, even if it’s well expected that China will push for more reform in investor protection, it is still worthwhile to know what we can do to address the inequalities caused by different national securities laws.

In the early nineties, the Chinese leaders realized that in order to improve its international competitiveness and to transform the loss-making state enterprises into self-sustaining modern corporations, they have to push for an economic reform through which the state-owned factories could then be held accountable for its performance.⁴² This prompted the so called “modern enterprise reform,” by which the government tried to cultivate a sense of responsibility among the managers by changing their evaluation standard from production to profit.⁴³ As a necessary part of this reform, the government needs to inject large amounts of money into these state-owned companies before they could be left on their own. Part of this money could come from the public offerings of such companies’ shares. However, when this reform is first put into practice in the early nineties, the officials in charge of such reforms also had to worry the market reform might offend some conservative political figures.⁴⁴ For example, they had to ensure the reform would not deviate too much from the traditional socialism theory that the production resources should be controlled by the state so that economy could be planned

by a central government to avoid market failures.⁴⁵ Thus, in order to allay the fears of the conservatives, as well as to avoid the potential political disorder that may be brought by the sudden change in social ideology (as witnessed in the eastern Europe and former Soviet Union in the early nineties),⁴⁶ the reformists wanted to make sure that the reform will at least keep the state's majority ownership in those former SOEs.⁴⁷ Therefore, the regulators designed a unique share structure, in which the shares of a company are divided into three types: state shares, legal person shares, tradable shares.⁴⁸ For our purposes, state shares and legal person shares could be treated as one type—both are non-tradable shares held by government or semi-governmental asset management companies. One thing to be noted here is that the concept of non-tradable shares in Chinese securities markets is different from that of unregistered shares as in United States—unregistered shares are still transferable—the only limitation is that the transfer cannot be consummated by a “public offering” as defined by the Securities Act of 1934 and relevant case law. Moreover, as long as the company decides to take the trouble to meet certain demands, such as information disclosure, public distribution of such shares will be allowed. Here, “non-tradable” means such shares cannot be offered to anyone other than a state asset management entity and there is no such thing as a registration for such non-tradable shares. If any such shares are to be sold to a non-governmental entities, they have to secure a special government approval.

Under such a scheme, China's capital markets have grown at a tremendous speed—till 01/16/2006, the two exchanges in China have a combined market capitalization of 3395.9 billion yuan (\$415.6 billion), second only to Japan in Asia.⁴⁹ Thus, to a certain degree the government realized its dual goal—injecting capital

injection while keeping control over these former SOEs. However, this immediate convenience also fostered quite a unique corporate governance problem that has been pestering the Chinese securities market and regulators ever since—now the state still retains the control over all major business decisions and the shareholders of the tradable stocks are effectively precluded from participating in or monitoring the management of these now “public” companies. Moreover, for fear that the courts are not ready to deal with the any possible claims against the issuers by defrauded investors, the court system was instructed not to accept such complaints—thus, minority shareholders almost completely lost their right to monitor the control persons in their companies. Although the National People’s Congress and the CSRC have passed numerous legislations as well as regulations in areas like corporate governance,⁵⁰ disclosure obligations, and insider trading,⁵¹ they have failed largely to rekindle domestic investors’ confidence in these listed companies.⁵² When more SOEs are due for a capital injection, suddenly everybody with such shares seems to have realized that they have become the last fools—and hence the sluggish market performance since 2000.⁵³

Given such a background, the Supreme People’s Court decided to revoke its policy not to accept private investor’s law suits. Although it still insists the Chinese courts are not fully equipped with the necessary judiciary expertise in such area, it is willing to make some concession. It’s not clear how the Court has been able to impose such substantial limitations as to an investor’s standing in contradiction of the express terms of the Securities Law of 1997, but it does not seem anyone, including the CSRC, is willing to question its constitutionality.⁵⁴ Therefore, the Regulation, though falling short

of many people's expectation, may be deemed a significant improvement compared with its prior ban of private securities litigation.

At the same time, in order to further the reform in the capital structure and the management control, the Chinese government changed its policy on securities market on two key aspects. First, it decides to eventually sell off state interest in all enterprises except for a few that the government regard as strategically important. Second, it also began to gradually allow foreign investors to make equity investment in Chinese companies (as one of the first steps to enable China be integrated into the international capital markets). A series of rules were then promulgated to implement these new ideas. Several of the most important ones are discussed below.

First, foreign investors could purchase of tradable shares from the Chinese securities exchanges under the Qualified Foreign Institutional Investors program ("QFII")⁵⁵, or through equity investment by foreign investor through securities fund established under the Regulations of Fund Management Companies ("FM")⁵⁶. Qualified Foreign Institutional Investors ("QFII") are defined in this Regulation as overseas fund management institutions, insurance companies, securities companies and other assets management institutions which have been approved by China Securities Regulatory Commission (hereinafter referred to as "CSRC") to invest in China's securities market and granted investment quota by State Administration of Foreign Exchange (hereinafter referred to as "SAFE").⁵⁷ Similarly, FM allows foreign investors to invest in tradable shares through a securities management fund. Both programs require foreign investors to be financial institutions with sound record and certain minimum

capital size. Since these two program have been introduced only recently, no disputes have arisen to a litigation stage, either in China or other countries.⁵⁸

Second, purchase of non-tradable shares through private placement.⁵⁹ As mentioned earlier, all such sales of legal-person and state-owned shares must seek special approval process first. In order to keep its promise made in its WTO membership application, and also in order to help with the problems created by the separation of tradable and non-tradable stock markets, China has started to allow the transfer of the non-tradable state-owned or legal-person shares to foreign investors.⁶⁰ Such shares will then become tradable, although not eligible for public offering through stock exchanges.⁶¹ Disputes arising from these transactions are not covered by *Several Regulations*, which only regulates securities transaction consummated through state-approved exchanges. However, such investors will usually receive comprehensive contractual protections. RBS' investment in Bank of China (BOC), the second largest bank in China, is just one such example.⁶² It was reported that RBS would receive compensation over three years if (a) the joint venture between RBS and BOC performs poorly, (b) BOC's initial public offering (IPO) price falls below the price that RBS paid for its investment, or (c) BOC's net asset value declines year-over-year.⁶³ Temasek, a Singaporean investment company, is also believed to have negotiated similar provisions for its stake in BOC.⁶⁴ Therefore for minority foreign shareholders, these guarantee provisions will no doubt add some downside protection to the value of their investments.⁶⁵ While foreign investors in China may want to keep their long-standing relationship with the state at stake, their profit orientation may very well drive them to invoke the guarantee provisions if necessary.⁶⁶

The above two types of transactions will most likely not pose the unequal treatment problem by a U.S. court. Transaction of the first type is conducted outside of US and only affects sophisticated investors who have intentionally decided to go into the Chinese securities market—so it cannot satisfy either the conduct or the effect test even for American investors. For the second type, although private placement may be covered by the federal securities law, the contractual protections could be so generous that it is less desirable for the overseas investors to go to a court; moreover, possible arbitration clause may also prevent investors to seek remedy in a US court.⁶⁷ Besides, most of the second type of transactions happen before the company goes public—therefore, it’s usually a transaction just between a state entity and a foreign investor, and there will be no third party effect.⁶⁸

Problems will arise when the underlying dispute is due to a Chinese company’s overseas public offering.⁶⁹ It is here that a US federal court is most likely to get involved and creates unequal treatments for shareholders. American residents can always bring law suits against foreign stock issuers under the federal securities law if the stock is offered through a U.S. stock exchange because their claims satisfy both the conduct or the effects test.⁷⁰ It is here a defendant issuer will argue that under the US law, non-US transactions shall be excluded from the class. Excluding such non-US investors not only means less litigation cost to a defendant issuer (supposedly, there will be less time spent on no-reliance defense), it may also significantly reduce any possible payout on the part of the issuer or control shareholder. For example, a certain feausance or non-feausance may be deemed fraud in the United States but only “irregularity” in Germany—therefore the possible compensation in a German court may be lower than that in US. Of course, one of

the most extreme disparities can be found in a China-US case—as we talked above, a compensable misdeed in US may not even be allowed to be brought to a court.⁷¹ In case of a double listing in the US and China by a Chinese issuer,⁷² if subsequently the issuer is not satisfied with its stock price, it might promulgate misinformation in Chinese to Chinese media to boost the price. On the other hand, it makes sure it does not do anything wrong in the US. The stock prices first go up in China, but later also in the US, either because the Wall Street gradually hears the news or because the space arbitrage (assuming arbitrage can be done despite capital regulation by the Chinese government). Gradually investor become suspicious and prices begin to fall in both countries. American investors then sue the issuer in the US and submit a class certification including the Chinese investors. But the court disagrees—presumably because the fraudulent conduct happens outside of United States and the foreign investors loss does not have a significant impact on U.S. capital markets based on past interpretation.⁷³ In China, CSRC investigates the matter but decides only to give the issuer a warning. Therefore, no remedy for the Chinese investor. However, the issuer still achieves its goal to boost the prices temporarily. The cost of this effort is minor—since it has relatively few American investors, compensation to them may be minor.

If this is what will happen in the future, rejecting foreign investors' claim could seriously undermine the regulator's goal to maintain the market integrity.⁷⁴ Although in theory there are pros and cons for a cross-listing in the US—for the pros, better reputation, more liquidity, etc; on the con side, more stringent regulation,⁷⁵ if a court distinguishes a claim based on a plaintiff's residence, the issuer could be induced to take some strategic action so that it could take the full advantage of the pros but limit effect of the cons to a

substantial degree. For example, the issuer could choose to offer only a very limited number of shares in the United States, thus get the reputation boost and maybe receive higher prices for its stocks elsewhere; then it makes sure that any problematic disclosure or transactions are done outside of the United States—therefore, US courts will not have a general jurisdiction over claims brought by those who suffered from outside of the US—if there's any damage to the US investors, it will be very limited. Can the US still claim that the securities law is to protect market integrity in such cases?

III. Proposed Solutions

Is there a better arrangement for the US to utilize than to blame other countries' inefficiency? After all, applying securities law in this discriminatory way does look it is "designed to permit local actors to enjoy the benefits of an activity while exporting the harm."⁷⁶ According to Guzman, treating foreign plaintiffs differently from domestic ones is inefficient as it allows globally inefficient activities to take place."⁷⁷ Three propositions, which can be readily discerned from the above discussion, will be discussed below.

A. Extending Subject Matter Jurisdiction under the Federal Securities Law

One direct response is just to extend subject matter jurisdiction to foreign investors' claims, if such foreign investors will otherwise be prejudiced in favor of their American counterparts. This could be achieved through either judicial reinterpretation or legislative actions. As mentioned above, such reinterpretation will be more in line with the common law principle of each treatment of shareholders.⁷⁸ Such treatment is neither a complete break with history because case law indicates courts do consider the availability of laws similar to the federal securities law in other countries' as a factor in their subject matter jurisdiction consideration.⁷⁹ For such a scheme to work, however, several obstacles need to be overcome first.

1. Class Certification

Although US courts admit that there are no per se rules against the certification of a class that includes both domestic and foreign investors,⁸⁰ in order to be included in a class,

plaintiffs must meet the four-pronged test set out in Federal Rules of Civil Procedure section 23(a), which states:

One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.⁸¹

It does not seem that foreign plaintiffs will need to overcome barriers different from those facing U.S. investors in order to be joined in a class, if subject matter jurisdiction is conceded by a court. Moreover, courts have said that “[i]n securities transactions where the complaints were based on the same ‘public statements and reports’ consolidation is appropriate if there are common questions of law and fact and the defendant will not be prejudiced.”⁸² Therefore, consolidation should not be a barrier for a foreign investor.

2. Substantive Law Analysis

Courts in general require the following elements in order to establish liability: (1) the defendant made a misrepresentation; (2) the misrepresentation concerned one or more material fact(s); (3) the misrepresentation was made knowingly, or with reckless disregard for the truth thereof, and with the intent to deceive or defraud; (4) the defendant made the misrepresentation “in connection with” a purchase or sale of securities; (5) the misrepresentation was made through interstate commerce, or of any facility of any national securities exchange; (6) the plaintiff relied upon defendant's misrepresentation;

and, as a consequence of plaintiff's reliance, purchased (or sold) the security in question; and (7) the defendant's misrepresentation is the proximate cause of plaintiff's monetary damage.⁸³

The plaintiff bears the burden of proving all elements of the cause of action brought under an express provision of the securities laws, or under SEC Rule 10b-5 as construed by the courts.⁸⁴ All such elements have been analyzed extensively by courts and legal scholars,⁸⁵ hence we need only to stress the unique aspects of a case where both foreign issuer and foreign investors are involved.

a. Communication Barrier and Proving Investor's Reliance

Because it is impractical for most injured investors to prove reliance in securities class action,⁸⁶ reliance is presumed to exist in two typical scenarios: the "Affiliated Ute" type,⁸⁷ and the "fraud-on-the-market" situation.⁸⁸ In the situation, the investor may recover under § 10(b) without a showing of reliance on the failure to disclose, if a person *under a duty to disclose* material information to an investor fails to do so. Later cases interpret this ruling as meaning reliance will be presumed if the defendant fails to disclose material information while he has a duty to do so. In the context of class actions involving both American and foreign plaintiffs, a natural follow-up question would be, what if the duty to the American investors is different from that to a Chinese investor? For example, under the US law, there is a duty to disclose certain information to the US investors, but the Chinese law does not require so. Can courts still presume reliance for the Chinese investors who have been consolidated in the class?

I believe the answer should be Yes—otherwise, equal treatment of shareholders cannot be realized. Moreover, the issuer has voluntarily agreed to be governed by the U.S. securities law when it decides to make a public offering here.⁸⁹ By choosing a higher regulatory standard, an issuer is not just buying an admission ticket to the U.S. capital market, it also stimulates investors outside of United States to be more interested in such stocks and thus, increase the financing capability of the issuer. Thus, an issuer does receive something in return when being required comply with a higher regulatory standard. If such obligation is consistently (instead of on a case-by-case basis) imposed on a foreign issuer, it will develop such an expectation that it shall comply with a higher standard. Hence, it will no longer be able to raise the argument that it has relied on its home country's securities law to decide whether to make certain disclosure. Nevertheless, such suggestion is based on the assumption that the US law does afford a higher standard of investor protection. It will be much trickier if the difference is something other than the *different level* of protection.

As to the fraud-on-the-market theory, the Supreme Court recognized its validity in *Levinson*, which “obviates the necessity that a plaintiff prove reliance and, instead, permits the rebuttable presumption that a plaintiff relied on the integrity of the market price in purchasing his or her shares of stock.”⁹⁰ However, the presumption of reliance is appropriate only if the company's stock was traded in an ‘efficient market.’”⁹¹ Courts have generally followed a five-factor test to determine market efficiency, namely, (1) whether there was a large weekly trading volume; (2) the existence of a significant number of reports by securities analysts; (3) the existence of market makers and arbitrageurs in the security; (4) the eligibility of the company to file an S-3 Registration

Statement; and (5) a history of immediate movement of the stock price.⁹² Case law has concentrated on the individual character of the underlying securities being traded—for e.g., whether a thinly traded security has an efficient market.⁹³

Should such a test be applied to stocks traded on an exchange outside of United States? It's not hard to imagine that due to the different regulation environment, history, economic conditions, etc, the operation of Chinese securities market might be very different from that of United States. Hence, is it necessary for the concept of "market" to include the trading market of the stock in China? Empirical studies do not seem to point to a conclusive result.⁹⁴ In addition, such studies do not suggest any individual stock has an efficient trading market—and there is still the question of whether information is efficient across border for such double-listed stocks. For e.g., how is a stock going to react if an alleged wrongdoer issued a false report in United States, but did not do so in China? Or vice versa? How about the report is only in English, while most investors in China do not read English?

Nevertheless, even if a stock does not have an efficient market in one trading market, space arbitrage will probably eliminate a double- or triple-listed stock's trading inefficiency in emerging markets.⁹⁵ Therefore, "given the unity of information with which the foreign and domestic markets now trade, and the effect each exchange has on the pricing of the other exchange, the purchasers on the foreign exchanges should also be entitled to the presumption of reliance on an efficient market."⁹⁶ However, space arbitrage has a prerequisite—the free flow of capital, which is not currently available in China because the Chinese government still does not allow the free convertibility of its current in capital accounts.⁹⁷ However, the gradual liberalization of the capital markets is

a stated goal of the Chinese government.⁹⁸ The measures in the past several years, including the gradual transformation of the fixed-exchange rate to a more flexible one and the opening up of the securities market to foreign institutional investors,⁹⁹ indicate that space arbitrage may become easier in the future and hence the improved efficiency in securities trading both within and without China.

b. Judicial Assistance for Discovery Request

In general, civil discovery request by the U.S. has seldom been honored by Chinese courts and such attempts by U.S. attorneys without authorization from Chinese government may be criminally punished.¹⁰⁰ However, in the context of securities litigations involving Chinese issuers, things may be a little different because of the many conflicting forces at play: first, the issuers may have a huge incentive to cooperate with the US courts to keep the U.S. capital markets available; second, other players in such litigations, due to the traditional state ownership and control of enterprises, government units may have influenced the actions of the issuers that could well be the center of a civil litigation in the United States—therefore, the government may want to cut US courts’ hands off themselves; and third, the Chinese government also has its judicial sovereign concerns.

However, adding Chinese investors to a securities class action brought in the United States does not necessarily make such discovery more difficult—the same barriers mentioned above will be experienced no matter they are added or not. The only additional burden will be the discovery as to the reliance element by the Chinese

investors—if fraud-on-the-market is applied across the national borderline, even such additional work is not necessary. Moreover, the existence of such difficulties does not necessarily mean that the cooperation of the U.S. and Chinese courts is impossible. Actually, private securities litigation may be one of the easiest area for substantive cooperation. First, the primary regulator of the Chinese securities market, CSRC, has shown keen interest in promoting the market integrity by borrowing experience from the U.S.—not only has it adopted many disclosure rules that mimic their American counterparts, it has also promised more cooperation with the SEC.¹⁰¹ Second, securities regulation is an area where ideology only plays a minimum part and hence there will be few, if any, political barriers against more reforms. Third, cooperation with the U.S. judicial systems is in the Chinese investors’ own interest to guard against issuers’ power abuse. Fourth, the Chinese central government has strong interests in cooperating with United States because it expects to receive some return benefits in other fields—for example, China is working hard to get the U.S.’ assistance in its criminal investigations against corrupt officials who have fled to the United States with huge amount of embezzled cash.¹⁰² Although Chinese court system may not welcome such cooperation as it will undermine its authority and add to its workload, it does not necessarily have that kind of power to obstruct it. Mr. Xiao Yang, the President of the Supreme People’s Court, a position that in name is equal to the premiership of the central government under the Chinese Constitution, only retains a membership of the Central Committee of the Community Party, a position far less glamorous than that of the politburo.¹⁰³ The Chinese court systems have also received very fierce criticism from almost all sides of the society...¹⁰⁴

c. Section 11 and Section 9 Problem

If an action is brought under section 11 of the Securities Act or section 9 of the Exchange Act, in order to ensure that foreign investors are not treated unfairly, it is necessary for the Congress to make changes to these sections so that they will not be excluded from being consolidated simply because they did not purchase their stocks from a US national exchange or their purchased stocks were not registered with SEC. As discussed in Part II(C), such legislative reform will in the long-term interests of the United States.

B. Contractual Solution

As an alternative, parties to a securities transaction may specify a dispute resolution arrangement through a contract, so that that potential investors will know in advance who may be compensated, how much and in what matter can they be compensated. For example, a stock purchase contract may include an arbitration clause that requires any fraud allegations and concurrent compensations requests be decided by an arbitrator, who shall observe the principle of equal treatment of shareholders. The problem is, shall a court enforce it?

The Supreme Court has ruled that contract terms concerning choice of law or forum will be presumed to be valid,¹⁰⁵ and the presumptive validity of a forum selection

clause can be overcome if the resisting party can show it is "unreasonable under the circumstances."¹⁰⁶ This "unreasonable" exception is to be applied narrowly—forum selection or choice of law clause is "unreasonable" if (1) their incorporation into the contract was the result of fraud, undue influence or overweening bargaining power,¹⁰⁷ (2) the selected forum is so "gravely difficult and inconvenient that [the complaining party] will for all practical purposes be deprived of its day in court."¹⁰⁸; or (3) if enforcement of the clauses would contravene a strong public policy of the forum in which the suit is brought, declared by statute or judicial decision.¹⁰⁹ Unfortunately, even such liberal attitude can rarely help the cause to treat shareholders equally because this "private arrangement" can hardly be extended to a *publicly* traded security, where thousands of "unscrupulous" individual investors have been implicated.

The courts' unwillingness to extend contractual arrangements to such transactions reflects their belief that the government has a strong interest even in such "private attorney" actions.¹¹⁰ However, "[securities] law is neither wholly private nor wholly public, but is instead at times public, at times private, and at times a curious blend of the two."¹¹¹ It's been pointed out that certain aspects of the securities regulation scheme, including the mandatory disclosure requirement, not only benefit the purchasers in the offering but also help all the people in the secondary market make informed decision based on such information furnished. Some other aspect of the securities law, and in our case the 10b-5 antifraud provision, has more limited implication. Such conflicting perceptions about the private securities action can sometimes be felt by federal courts. For example, one circuit held in *Scherk v. Alberto-Culver Co.* that "a contractual remedy provision specifying in advance the forum ... and the law to be applied is ... an almost

indispensable precondition to achievement of the orderliness and predictability essential to any international business transaction ... [because] such a provision obviates the danger that a dispute under the agreement might be submitted to a forum hostile to the interests of one of the parties or unfamiliar with the problem involved.”¹¹² However, a Ninth Circuit panel decision distinguished Scherk:

“The fragmentary contacts with the United States of the contract in Scherk distinguish that contract from the contacts here ... In the securities cases upholding arbitration clauses by virtue of the Arbitration Act, the Supreme Court has observed that arbitration changes procedure but that arbitrator will apply the substantive law of the United States where the law is applicable.... The strong implication is that where there is substantial contact with the United States even the Arbitration Act could not authorize the waiver of substantive provisions of the 1933 and 1934 Acts.”¹¹³

The Ninth Circuit later reversed the panel decision and upheld the arbitration clause.¹¹⁴ One district in the Second Cir., however, was persuaded by the panel decision in a subsequent case (Lloyd’s)—and thus casts doubts as to the continued validity of the presumption of validity.¹¹⁵

Nevertheless, even if “the private components of securities regulation have to be backed by a public backbone,”¹¹⁶ it is not clear why courts have to save the investing public’s confidence in the securities market at the expense of foreign investors who happen to have bought stocks from the same issuer. More importantly, the effect of such contractual protection is exactly to make sure that every shareholder’s interest, and hence the investing public, can be protected—in this sense, a contractual term used to guarantee

equal treatment of shareholders, such as mandatory arbitration in case of allegations against the issuer and mandatory compensation to all non-fault shareholders in case of “guilty” finding, will not interfere with a court’s interest of providing such a public bone.

Alternatively, if a contract arrangement cannot replace federal securities law, it may be applied in addition to it. For example, when U.S. shareholders of a foreign issuer bring a class action under the antifraud provision in a US court, other shareholders shall be allowed to bring a *supplemental action* to enforce such their contractual rights,¹¹⁷ so that in case there will be a favorable judgment to the class, they can receive an equal amount of compensation from the issuer, or the control shareholder. Under this arrangement, the public v. private nature of the securities law problem can be avoided.

C. Market Approach and Portable Reciprocity

A third approach to eliminate the unequal treatment of shareholders due to shareholder litigation can be found in the “market approach” to securities regulation, under which “[an] issuer's securities domicile controls for all securities sold in the United States, whether that domicile is a U.S. state or a foreign nation.”¹¹⁸ In theory, this means any disputes arising out of such transactions, including a private action against a foreign issuer brought by U.S. investors, shall be governed by the substantive and procedural rules of the issuer’s domicile country.¹¹⁹ However, in order to reduce the litigation cost to the U.S. investors and to increase investment interests, it is suggested that the SEC could require such issuers to consent to be sued in a US court, which may then apply US procedural law.¹²⁰ If this is a plausible, the unequal treatment can be partly eliminated

because the substantive law used in such litigations will be the same—it will reduce the possibility that an investor may be treated less fairly than his American counterpart and that he/she will be forced to pay another's loss. However, unless the procedural law applied is also that of the domicile country, discrimination can still exist—especially if it is much less favorable to the plaintiff as that in the United States.¹²¹

Another method related to the market approach is described by Choi and Guzman as portable reciprocity.¹²² Under their theory, governments should allow an issuer of securities to select the regulatory regime that will govern its securities. Once the regime is selected and the issuer has complied with its requirements, securities transactions may commence in any country without additional compliance work. Portable reciprocity is different from the market approach in that first, it relied on the cooperation of national governments instead of private arrangements between an issuer and a regulator; second, Choi carries his theory one step further by proposing that the default forum for any enforcement action should be brought in the home country of the chosen regulatory regime. Thus, for our example, in order to avoid the different treatment of shareholders based on residence, a Chinese issuer should be allowed to apply the relevant Chinese law to govern its offering in the United States and US investors will of course, be notified of such choice before making any investment decisions. If any fraud allegation is brought by an investor, discrepant treatment of shareholders can largely be avoided because jurisdiction will not longer be an obstacle, whether he/she is an U.S. or Chinese resident (as access to a foreign court is arranged in advance). Moreover, claims of different shareholders will be judged by the same procedural and substantive rules. As to the argument that this will decrease investor protection, the author would point out that this is

an investor choice problem—if market does not value the legal protection of a certain country, the issuer has to make its offer otherwise very appealing in order to persuade investors, or even apply the U.S. law if that is what the market values most. As some scholars have pointed out, there is not empirical evidence showing that such “deregulation” will lead to a race to the bottom.¹²³ Again, this theory will have a strong suggestion that securities regulation is private in nature and private parties should be allowed to make any arrangement they want; securities law does not have to be always paternalistic to those who cannot make rational decisions.

If such comprehensive treaty could be forged between different nations, it may overcome all the practical difficulties we discussed in the other two choices—dispute resolution could be conducted through neutral special arbitration process, enforcement of the awards would bypass the protectionism of local courts, process could be cheaper, etc. In addition, the fear of having to litigate in a courtroom that is most favorable to plaintiffs, which has been an important deterring factor in foreign issuers’ consideration for a cross-listing in the U.S., may be eliminated under such an arrangement.¹²⁴ However, “efforts on the part of countries to construct workable international cooperation in securities regulation, although fine in theory, are most likely to fail.”¹²⁵

But there is always hope. As we have witnessed, the integration of the world economy is an unavoidable trend for the future. This will require more streamlined international regulatory scheme. Although it does not necessarily mean in the future one single set of law will emerge,¹²⁶ we should be confident that gradually, there will be a forum for different countries to sort out their differences in a reasonable manner. To see this trend, one just needs to look at China—within only about 25 years, it has emerged

from its xenophobia and anti-capitalism as a country willing to learn from and work with other nations. It has become a signatory to the Washington Convention on International Settlement of Investment Disputes (WCISID), which enables member states to settle any investment disputes through arbitration at an international forum, and the arbitration awards can be enforced as a treaty obligation between states.¹²⁷ It has joined the WTO. The Chinese securities regulator has also signed numerous Memorandum of Understanding with securities regulation authorities in other countries that are intended to strengthen investor protection in the international securities market.¹²⁸ The SEC and CSRC is also planning to sign a cooperation agreement in early 2006.¹²⁹ Although such understandings cannot solve the problem we have here, it is a clear indication of China's willingness to enhance cooperation with other securities regulators.

IV. Conclusion

The exclusion of foreign investors from securities class action against an foreign issuer, whether on jurisdictional and registration ground, will result in shareholder discrimination on the basis of residence. Although this does not seem to be a big concern for the U.S. investors now, with the integration of international securities markets and the rise of transnational economy, it may eventually become a disincentive for foreign companies to seek capital in the United States and thus deprive U.S. investors' opportunities to invest in such stocks. Moreover, it will weaken investors' confidence that the securities regulation scheme in the United States is designed to maintain its market integrity. This note proposes several, instead of exhausts all, possible remedies for this problem, including expanding the subject matter jurisdiction to foreign claims, enforcing contractual dispute solution terms, and market approach guaranteed by treaties. Each of these proposed solutions may have its own deficiencies—for example, to ensure foreign shareholders can be joined in a securities class action brought in the U.S., one has to persuade federal courts to change their long-time understanding of the subject matter jurisdiction in extra-territorial transactions. However, it is the author's belief that a practical solution will eventually emerge, because it is to the long-term interest of all countries concerned.

¹ Several of the most important cause of actions are Section 10b of Exchange Act of 1934 and the relevant SEC Rule 10b-5 (the "antifraud provisions"), which applies to both registered and unregistered offering; in registered offering, Section 11 and 12 of the Securities Act of 1934. Moreover, "the remedies supplied by

and under [the Exchange Act and the Securities Act] are cumulative and not mutually exclusive. *Jordan Bldg. Corp. v. Doyle, O'Connor & Co.*, 401 F.2d 47, 51 (7th Cir. 1968).

² USCS Fed Rules Civ Proc R 23.

³ See e.g., *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974. For more references, see the Role of Foreign Investors in Federal Securities Class Actions, 1442 PLI/Corp 91.

⁴ Neither the Securities Act of 1933 nor the Exchange Act of 1934 is clear as to its extraterritorial application. See e.g., *Itoba Ltd. v. LEP Group PLC*, 54 F.3d 118, 121 (2d Cir. 1995). See also, *The Role of Foreign Investors in Federal Securities Class Actions*, 1442 PLI/Corp 91 at 111.

⁵ *Subject Matter Jurisdiction of Securities Fraud Action Based on Foreign Transactions, under Securities Exchange Act of 1934*, 56 A.L.R. Fed. 288, section 2.

⁶ *Id.*

⁷ *The Role of Foreign Investors in Federal Securities Class Actions*, 1442 PLI/Corp 91, 114.

⁸ See section 11, Securities Act of 1933; Thomas Lee Hazen, *Liabilities Under the 1933 Act*, Fed. Securities Law III.E.2 (2d ed.).

2. Private Rights of Action

⁹ Chinese version available at <http://www.people.com.cn/GB/jinji/35/159/20030110/905268.html>.

¹⁰ The Chinese courts banned such suits ever since they were first brought to a court in 1998. On Sept. 21, 2001, although facing a tremendous public outcry against some issuers' insider trading, the Supreme People's Court published A Notice Concerning Temporarily Banning Civil Securities Cases Related. See *A Summary of Historical Developments of Civil Compensations related to Securities Fraud*, Beijing Morning, Jan 11, 2003 issue, available at <http://finance.sina.com.cn/t/20030111/1154301026.shtml>.

¹¹ 15 U.S.C. §§ 77a-77aa. For a general discussion of such provisions, see 'Neither Unusual Nor Unfortunate': the Overlap of Rule 10b-5 with the Express Liability Sections of the Securities Acts, 60 TXLR 719.

¹² See e.g., *Schaefer v. First Nat'l Bank of Lincolnwood*, 509 F.2d 1287 (7th Cir. 1975), cert. denied by *Rodman & Renshaw v. Schaefer*, 425 U.S. 943.

¹³ This is unlike the situation where entities other than the issuer are held liable—for e.g., actions against directors or officers under section 16 or those abetting violation under 20(a) of the Exchange Act.

¹⁴ 15 U.S.C. §§ 77k.

¹⁵ *Id.* Also note that section 11 of the 33 Act does not apply to offshore offering under Regulation S because "Regulation S limits the extraterritorial application of the Securities Act by eliminating the registration requirements for many offshore transactions and by providing greater predictability with regard to the application of U.S. securities laws to offshore offerings." Uri Geiger, *The Case for the Harmonization of Securities Disclosure Rules in the Global Market*, 1997 Colum. Bus. L. Rev. 241, 256 (1997).

¹⁶ For example, Sinopec has made its public offering in both United States and China. The shares it sold in China are called A share while those in United States are called N shares—each is subject only to its local registration rules.

¹⁷ 15 U.S.C. §§ 78i(e).

¹⁸ See *United States v. Aluminum Company of America*, xxxx; see also Robert W. Hill, *Cross-Border Investment, Conflict of Laws, and the Privatization of Securities Law*, 55-Aut Law & Contemp. Probs. 331, 334-35.

¹⁹ *Timberlane Lumber Co. v. Bank of America*, 549 F.2d 597, 610.

²⁰ *Id.* at 611.

²¹ *Id.* at 612.

²² See e.g., *Bersch*, 519 F.2d at 984-90 (“[W]e think, [that General adverse is not enough to grant subject matter jurisdiction] is what Judge Hand had in mind in the remarks in his Aluminum opinion...”). See also Hillman, *Cross-Border Investment, Conflict of Laws, and the Privatization of Securities Law*, 55-Aut Law & Contemp. Probs. 331, 333-36.

²³ *Itoba*, 54 F.3d at 122 (quoting *Psimenos v. E.F. Hutton & Co.*, 722 F.2d 1041, 1045 (2d Cir. 1983); *IIT v. Vencap, Ltd.*, 519 F.2d 1001, 1017 (2d Cir. 1975)). See also, 1442 PLI/Corp 91, footnote 66 for more references.

²⁴ 1442 PLI/Corp 91 at 113.

²⁵ *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, ...

²⁶ *Kasser*, 548 F.2d at 114; *Tri-Star*, 225 F. Supp. 2d at 576 (the level of domestic conduct must be significant and material to the fraud and not merely prepartory)

²⁷ *Europe & Overseas*, 147 F.3d at 129.

²⁸ See e.g., *Tri-Star Farm Ltd. V. Marconi PLC* (the court held that it lacked subject matter jurisdiction over foreign investors’ claims against the foreign issuer because the alleged fraudulent conduct was conceived and carried out in the United Kingdom); *Baan*, (foreign investors are excluded from the class because the alleged misconduct mainly happened outside of United States—even though both American and foreign investors are affected by the misconducts)

²⁹ Securities Exchange Act of 1934, § 14(d)(7), as amended, 15 U.S.C.A. § 78n(d)(7); 17 C.F.R. § 240.14d-10. Best price rule also provides for a private right of action. See *Katt v. Titan Acquisitions, Ltd.*, 133 F.Supp.2d 632, 639.

³⁰ In *Tooley v. AXA Financial, Inc.*, 2005 WL 1252378, the Court held in dicta that “The idea that all stockholders should be treated equally does not apply in every circumstance, and there are occasions where boards of directors are permitted to treat different groups of stockholders differently, as long as it is in accordance with their fiduciary duties. See *Unocal Corp. v. Mesa Petroleum Corp.*, 493 A.2d 946, 956-957 (Del.1985)(holding that a discriminatory selective exchange offer was valid “[i]f the board of directors is disinterested, has acted in good faith and with due care, its decision in the absence of an abuse of discretion will be upheld as a proper exercise of business judgment.”); *Nixon v. Blackwell*, 626 A.2d 1366, 1377 (Del.1993)(“It is well established in our jurisprudence that stockholders need not always be treated equally for all purposes.”); *Cheff v. Mathes*, 199 A.2d 548, 554-56 (Del.1964). These cases demonstrate that a board of directors, in certain circumstances, may treat different classes of stockholders unequally. In doing so, however, they must satisfy the full import of their fiduciary duties.

³¹ *Id.* at 5. This principle also prohibits non-pro-rata distributions, and thus preventing controlling shareholders from favoring themselves. See, e.g., *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 721-22 (Del. 1971); *Bainbridge*, supra note 1, § 7.4, at 338-42.

³² See *Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470, 493 (1974) (a long-existing state law cannot be preempted by a federal law simply because they may overlap each other)

³³ *In re The BAAN Company Securities Litigation*, 103 F.Supp.2d 1, 10 (D.D.C. 2000).

³⁴ See Robert DeLaMater, Testimony before U.S.-China Economic and Security Review Commission, available at http://www.uscc.gov/hearings/2005hearings/written_testimonies/05_08_11wrts/delamater_robert_wrts.htm.

³⁵ Given China's special shareholder structure, this is especially true.

³⁶ The usual practice is that unless it could be established with some certainty that the foreign court would give no consideration to a US court judgment, subject matter jurisdiction over foreign investors' claim cannot be denied solely on this ground. Vast majority of U.S. courts have rejected the Second Circuit decision in *Bersch v. Drexel Firestone, Inc.*, as authority for the proposition that *res judicata* concerns prohibit certification of a class that includes foreign members. *The Role of Foreign Investors in Federal Securities Class Actions*, 1442 PLI/Corp 91, 108-111.

³⁷ There is not a foreign judgment recognition treaty between the US and China. The *Hague Convention on the Recognition and Enforcement of Foreign Judgment in Civil and Commercial Matters*, which is created to harmonize the enforcement rules in different countries, has not been very successful so far and only four countries have decided to join it. The treaty Member state information available at http://hcch.e-vision.nl/index_en.php?act=conventions.statusprint&cid=78.

³⁸ See *supra* note 10.

³⁹ *Id.* For a detailed interpretation, see also Walter Hutchens, *Private Securities Litigation in China: Material Disclosure about China's Legal System?*, 24 U. Pa. J. Int'l Econ. L. 599, 629-49.

⁴⁰ For some general information about the difficulties an investor can face in such civil law suits, see A Shareholder's Bitter Success, available at <http://cn.biz.yahoo.com/05-09-2/ctca.html>.

⁴¹ Sinopec, PetroChina, and China Life, three former state-owned enterprises with large capitalizations, have all received positive investor reaction after their listing in New York Stock Exchange according to the Wall Street Journal online charting.

⁴² The Central Committee of the Chinese Communist Party, *Several Decisions Concerning the Socialist Market Economy Reform*, available at http://222.66.11.66:8080/wx/Article_Show.asp?ArticleID=583.

⁴³ *Id.*, at section 2.

⁴⁴ Premiere Zhu Rongji, *Several Questions in Modern Enterprise Reform*, available at <http://www.people.com.cn/GB/33831/33836/34152/34156/2540251.html>.

⁴⁵ For more discussion on this issue by Chinese orthodox theorists, see *A Comment on Recent Discussion of the Socialism*, *Economic Review*, 1983 (author information not available), available at <http://www.dufe.edu.cn/organization/yanjiujigou/e&s/introduction/center-policy/wenxian/reform/32.doc>.

⁴⁶ Although a detailed study is not impossible due to political constraints, to appreciate the Communist Party's concern over ideology, one just needs to compare China's history before and after it came into power. Before Communist Party came into power, hunger had almost always been a source of social unrest; however, in the Great Leap Forward period (1958-1960), although millions of people died from hunger or hunger-induced diseases, the society on the whole had been relatively peaceful. Till today, many people still believe that the difficulties were mainly caused by natural disasters and Mao suffered the same way as

a common peasant. For a more general discussion of that period in English, see Jasper Becker, *Hungry Ghosts: Mao's Secret Famine* (published by Owl Books, 1998).

⁴⁷ See e.g., To Further Enhance the Basic Economic Scheme, available at <http://www.people.com.cn/GB/guandian/1035/2165875.html>.

⁴⁸ For more detailed discussion, see Jiangyu Wang, China's Securities Experiment: the Challenge of Globalization, <http://www.eastlaw.net/research/securities/sec2d.htm>. The following is quoted from it.

Roughly, there are four types of shares: State shares, Legal person shares, individual shares, and foreign capital shares. The basic rationale under the classification is to control the transferability of different types of shares: State shares and legal person shares are theoretically nontransferable, foreign shares may only be traded in a special, closed market, and individual shares may be transferred only between Chinese citizens.

State Shares (Guo Jia Gu) State shares refer to shares held by governmental agencies or authorized institutions on behalf of the State. According to relevant regulations, it shall include: (1) The shares converted from the net assets of SOEs which have been transformed into joint stock companies. (2) Shares initially issued by companies and purchased by the governmental departments investing on behalf of the State. (3) Shares initially issued by companies and purchased by the investment companies, assets management companies, and economic entity companies authorized to make investment on behalf of the State. State shares are not allowed to be traded on an open market.

Legal Person Shares (Fa Ren Gu) Legal person shares refer to shares of a joint stock company owned by another company or institution with a legal person status. The legal person shares can be indirectly held by the State if the shareholders are State-owned companies. Basically, there are four types of owners for legal person shares, namely, state-owned legal person shares, collective enterprise legal person shares, private enterprise legal person shares, foreign invested enterprise legal person shares, and institutional legal person shares. The transfer and trading of legal person shares are also restricted.

Individual Shares or A Shares (Ge Ren Gu) Individual shares, with an official recognized nick name of "A shares", refer to shares that may only be owned by Chinese citizens. A shares has the full function born by classic stock, and it can be freely traded and transferred in domestic markets.

Foreign Capital Shares (Wai Zi Gu) Foreign capital shares include B shares and overseas listing shares. B shares are shares which are offered exclusively to foreign investors. Like other shares, they are denominated in RMB, but Chinese citizens are not permitted to own or trade in B Shares. Issuing B shares is another channel for Chinese companies to raise foreign capitals. Overseas listing shares are shares issued by Chinese companies listed on securities markets outside mainland China. Among which are H shares, N shares and L shares:

H shares are offered by Chinese companies listed on Hong Kong Stock Exchange. They are subscribed for and traded in Hong Kong Dollars, and denominated in RMB. They can only be purchased and traded by Hong Kong local investors or overseas investors.

N shares are issued to foreign investors on US stock exchanges. They are denominated in RMB and subscribed for in US dollar. Dividends are declared in RMB but paid in US dollars. In fact, N shares are not traded directly on stock exchanges but are issued by way of ADRs (American Depositary Receipts). L shares are issued on London Stock Exchange according to a memorandum of understanding signed between U.K and China's relevant authorities on October 7, 1996.

⁴⁹ Data from *Statistics of Stock Trading on Nationwide Basis*, published by People's Bank of China (China's Central Bank), at <http://www.pbc.gov.cn/diaochatongji/tongjishuju/gofile.asp?file=2005S7.htm>.

⁵⁰ Code of Corporate Governance for Listed Companies in China, issued by China Securities Regulatory Commission and State Economic and Trade Commission, Zhengjianfa No. 1 of 2002, available at http://www.ecgi.org/codes/documents/code_en.pdf.

⁵¹ The Securities Law has specific provisions regulating disclosure requirements and insider trading. For a general discussion of insider trading problems and regulations, see Hui Huang, *The Regulation of Insider Trading in China*, 2 (2005) 17 *Australian Journal of Corporate Law* 1 (arguing that the Chinese law governing insider trading has serious problems due to the uncritical implantation of overseas experience.)

⁵² For example, five years ago the Shanghai Index was around 1900 to 2100 points—but for the past two years it is consistently hovering from 1000-1300 points. Information available at <http://www.sse.com.cn/sseportal/ps/zhs/hqjt/hq4.jsp>. As commented by an economist, “[i]t is one of the greatest paradoxes of the Chinese economy that its stock market, called the A share market, has lost half of its value in the past five years, while the economy has grown by 50%.” Weijian Shan, *The Mystery of China’s Sinking Stocks*, Far East Economic Review, December 2005, available at <http://www.feer.com/articles1/2005/0512/free/p005.html>.

⁵³ To see index changes, one can consult the website, <http://www.sse.com.cn/sseportal/ps/zhs/hqjt/hq4.jsp> in footnote 52.

⁵⁴ The Supreme People’s Court’s “interpretation” of Securities Law of 1999 is more like a “regulation” as the Court imposes significant limitations on an investor’s rights to sue, none of which are to be found in the text of the Securities Law 1999.

⁵⁵ Available at http://www.chinaamc.com/english_home_QFII%20LOW.htm.

⁵⁶ 证券投资基金管理公司管理办法, available at http://news.xinhuanet.com/fortune/2004-09/27/content_2027625.htm, is said to have replaced the older “Rules on the Establishment of Foreign-shared Fund Management Companies”—but what are the difference. The qualifications for the foreign shareholders of such fund management are: 中外合资基金管理公司的境外股东应当具备下列条件: (一)为依其所在国家或者地区法律设立,合法存续并具有金融资产管理经验的金融机构,财务稳健,资信良好,最近3年没有受到监管机构或者司法机关的处罚; (二)所在国家或者地区具有完善的证券法律和监管制度,其证券监管机构已与中国证监会或者中国证监会认可的其他机构签订证券监管合作谅解备忘录,并保持着有效的监管合作关系; (三)实缴资本不少于3亿元人民币的等值可自由兑换货币; (四)经国务院批准的中国证监会规定的其他条件

⁵⁷ Article 2 of QFII, Article 5: “CSRC and SAFE shall, in accordance with the laws, supervise and govern the securities investing activities undertaken by QFII within the jurisdiction of China.” Available from www.csrc.gov.cn.

⁵⁸ (give a list of the financial institutions that have been approved as QFII or FM)

⁵⁹ available at <http://www.setc.gov.cn/dwjxycyb/200211130019.htm>

⁶⁰ The Regulations Concerning the Transfer of State-owned and Legal Person Shares, available at <http://www.people.com.cn/GB/jinji/35/159/20021104/857594.html>.

⁶¹ See *id.*; such transfers also have to follow the Handling of the Transfers of Non-tradable Shares of Listed Companies Rules, issued collectively by Shanghai Stock Exchange, the Shenzhen Stock Exchange and the China Securities Depository and Clearing Corporation Limited on December 15 2004, available at <http://www.chinalawandpractice.com/default.asp?Page=1&cIndex=2&SID=4435&M=3&Y=2005>.

⁶² Asia Times, available at http://www.atimes.com/atimes/China_Business/GI30Cb03.html:

⁶³ Bei Hu, *RBS in Line for Compensation if Stake in BOC Turns Sour*, South China Morning Post, 8/26/05 S. China Morning Post 1.

⁶⁴ See *supra* footnote 62.

⁶⁵ *Id.*

⁶⁶ “While many believe that the guarantee clauses are unlikely to be invoked, one only has to look at Ripplewood’s decision to exercise the safeguard provision it received for its investment in Japan’s Shinsei Bank. As the actual size of the NPLs on Shinsei’s balance sheet was hard to determine at the time of Ripplewood’s investment, the Japanese government agreed to repurchase bad loans that lost 20% of their

value within three years from the acquisition. But the government did not expect Ripplewood to take the cancellation rights provision seriously, and Shinsei's subsequent decision to bind the government to the agreement and sell 1 trillion yen of NPLs back to the government stirred up considerable controversy in Japan.” http://www.atimes.com/atimes/China_Business/G130Cb03.html

⁶⁷ RBS and Temasek’s deal with Bank of China in the previous paragraph is one example.

⁶⁸ The foreign investors’ purchase of Constructions Bank, Bank of China, etc, all fall into such pattern. See ...

⁶⁹ For the Chinese companies, the three most utilized overseas stock exchanges are Hong Kong Stock Exchange, New York Stock Exchange, and London Stock Exchange.

⁷⁰ *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 993 (2nd Cir. 1975), cert. denied, 423 U.S. 1018 (1975).

⁷¹ See *supra*, section II.D on page 11.

⁷² Sinopec is an example. Memorandum of Law in Support of Defendants’ Motion to Dismiss the Consolidated Complaint (Sidley Austin Brown & Wood)

⁷³ See, *supra* notes 7, 8, and 11.

⁷⁴ As to the importance to maintain the investing public’s confidence in the securities market, the Supreme Court once noted, “It has been noted that ‘it is hard to imagine that there ever is a buyer or seller who does not rely on market integrity. Who would knowingly roll the dice in a crooked crap game?’” *Basic Inc. v. Levinson*, 485 U.S. 224, 247-48 (quoting *Schlanger v. Four-Phase Systems Inc.*, 555 F.Supp. 535, 538 (SDNY 1982)).

⁷⁵ For a discussion of cross-listing’s benefits, see John C. Coffee, Jr., *Competition Among Securities Markets: A Path Dependent Perspective*, available at <http://papers.ssrn.com/abstract=283822>; G. Andrew Karolyi, *The World of Cross-Listings and Cross-Listings of the World: Challenging Conventional Wisdom*, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=577021.

⁷⁶ See Guzman, *Choice of Law: New Foundations, National Treatment of Foreign Plaintiffs*, 90 Geo. L.J. 883, 927.

⁷⁷ *Id.*

⁷⁸ See *supra* notes 31-33.

⁷⁹ *Richards v. Lloyd's of London*, 135 F.3d 1289, (this citation may not be the best one to show my point here—need more research)

⁸⁰ *Takeda v. Turbodyne Technologies, Inc.*, 67 F.Supp.2d 1129 (C.D.Cal.1999) (citing *In re Gaming Lottery Securities Litigation*, 1999 WL 102755, *11 (S.D.N.Y. Feb. 25, 1999) (certifying a class composed of both American and Canadian investors, and rejecting defendants’ claim that Canadian investors were inadequate class representatives on the basis that it was “without merit”); and *Jordan v. Global Natural Resources*, 102 F.R.D. 45, 52 (S.D.Ohio 1984) (conditionally certifying a class where defendants sought to exclude foreign purchasers of stock but failed to adduce evidence that foreign jurisdiction would not give res judicata effect to judgment))

⁸¹ Fed. R. Civ. P. 42(a).; PSLRA

⁸² See e.g., *Mitchell v. Complete Mgmt., Inc.*, 1999 WL 728678, at 1 (S.D.N.Y. Sept. 17, 1999)

⁸³ Cause of Action for Securities Fraud under Section 10(b) or the 1934 Securities Exchange Act and/or Rule 10b-5, 9 Causes of Action 2d 271 (2005). It is important to note that Rule 10b-5 claims can be, and often are, made against not only the issuer, but also against its officers and directors, any person who controls the issuer and the issuer's underwriters. *Id.*, section 47.

⁸⁴ *Thiele v Shields* (DC NY) 131 F Supp 416; *Murphy v Cady* (DC Me) 30 F Supp 466, *aff'd* (CA1 Me) 113 F2d 988, *cert. denied*, 311 US 705.

⁸⁵ See *id.*

⁸⁶ “The issue of reliance on an omission or misrepresentation frequently arises in the context of efforts to certify a plaintiff class, without which a § 10(b) action is frequently impractical. Counsel for a defendant who opposes such certification may argue that, although the plaintiff class may avail itself of a presumption of reliance to avoid the need for individual proof of reliance, the possibility that the proposed class representative will be subject to rebuttal of the presumption by proof of actual nonreliance vitiates the typicality of his or her claim.” *When Is It Unnecessary to Show Direct Reliance on Misrepresentation*, 93 A.L.R. Fed. 444, § 2[b].

⁸⁷ *Affiliated Ute Citizens v United States*, 406 US (1972), *reh den* 407 US 916, *reh den* 408 US 931.

⁸⁸ *In Basic, Inc. v. Levinson*, 485 U.S. 224, 108 S.Ct. 978, 99 L.Ed.2d 194 (1988).

⁸⁹ This choice has been explained by two theories, namely “market segmentation” explanation and corporate governance or “bonding” hypothesis. See Coffee Jr., John C., *Competition Among Securities Markets: A Path Dependent Perspective* (March 25, 2002), Columbia Law and Economics Working Paper No. 192 (“‘Bonding’ is a term of art in modern institutional law and economics. It refers to the costs or liabilities that an agent or entrepreneur will incur to assure investors that it will perform as promised, thereby enabling it to market its securities at a higher price. The paradigmatic example would be the surety bond purchased by the agent and protecting its shareholder principals. The term was coined in Jensen & Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J. Fin. Econ.

305 (1976)”). See also Cally Jordan, *International Cross-Listing and Bonding: the Chameleon Effect*, p2-3, available at <http://www.law.ufl.edu/faculty/publications/pdf/jord.pdf>.

⁹⁰ “Commonly referred to as “the fraud-on-the-market theory,” this approach assumes that in an efficient market, all the available information about the company is quickly reflected in the price at which people are willing to buy and sell the stock. *Freeman v. Laventhol & Horwath*, 915 F.2d 193 (6th Cir.1990). Thus, the theory continues, “[i]nvestors rely on the price of the security as an accurate reflection of its worth. They, therefore, rely indirectly on such misrepresentations, even if they do not rely on them directly.” *Id.* at 197 (citations omitted). Consequently, “[t]he fraud on the market theory cannot be applied logically to securities that are not traded in efficient markets.” *Id.* at 198. Here, the determinative question now becomes whether IAS stock traded in an efficient market, thereby allowing Plaintiffs the benefit of the presumption.” *SERFATY v. INTERNATIONAL AUTOMATED SYSTEMS, INC., et al.*, Civ. No. 96-CV-583

⁹¹ *Id.*

⁹² See e.g., *Cammer v. Bloom*, 711 F. Supp. 1264 (D.N.J. 1989); *Freeman*, 915 F.2d 193, 199 (6th Cir. 1990).

⁹³ See *id.*

⁹⁴ See Ali F. Darrat and Maosen Zhong, *On Testing the Random-Walk Hypothesis: A Model-Comparison Approach*, *The Financial Review* 2000 35:3 105 (certain tests suggest Chinese stock markets are not

efficient). Contrast *Michelle L. Barnes and Shiguang Ma*, Market Efficiency or Not? The Behavior of China's Stock Prices in Response to the Announcement of Bonus Issues, available at <http://www.adelaide.edu.au/cies/papers/0120.pdf> (The hypothesis of semi-strong form market efficiency is rejected only partly for China's stock markets.)

⁹⁵ Even in inefficient securities market, given the free flow of information, "any price discrepancies between exchanges will quickly disappear to the price in the efficient market." Brian P. Murray and Maurice Pessa, *The Accident of Efficiency: Foreign Exchanges, American Depository Receipts, and Space Arbitrage*, 51 Buff. L. Rev. 383 ("For example, even if the Montreal Exchange were itself inefficient, if Company X sold for \$10.00 on the Montreal Exchange and \$10.50 in New York, there would quickly be buyers in Montreal who would buy at \$10.00 there and sell at \$10.50 in New York.")

⁹⁶ *Id.* at 385.

⁹⁷ The Economist Intelligence Unit, *Country Finance—China, Foreign Exchange Regulations*, page 59-64 (Released August 2005).

⁹⁸ *Id.*

⁹⁹ *Id.*

¹⁰⁰ Obtaining evidence without Chinese government's authorization may carry serious consequences for American lawyers. International Business Litigation & Arbitration 2005, China, 721 PLI/Lit 1311, 1315.

¹⁰¹ See e.g., Chairman Christopher Cox's speech in Beijing, on October 18, 2005, available at <http://www.sec.gov/news/speech/spch101805cc.htm>.

¹⁰² See e.g., *The Key Points in the Judiciary Cooperation between China and United States*, 21th Century Economic Report (人大刑法专家谈余振东案 中美司法合作关键, 21世纪经济报道), April 21, 2004 issue, available at <http://finance.sina.com.cn/g/20040421/0820729740.shtml>.

¹⁰³ See official biography of Xiao Yang, available at http://news.xinhuanet.com/ziliao/2002-03/01/content_295423.htm.

¹⁰⁴ See Zheng Gongchen, *Judicial Justice Is the Basis of a Harmonious Society*, available at <http://theory.people.com.cn/GB/40536/3341795.html>.

¹⁰⁵ *M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 8-10. ("The expansion of American business and industry will hardly be encouraged if, notwithstanding solemn contracts, we insist on a parochial concept that all disputes must be resolved under our laws and in our courts. Absent a contract forum, the considerations relied on by the Court of Appeals would be persuasive reasons for holding an American forum convenient in the traditional sense, but in an era of expanding world trade and commerce, the absolute aspects of the doctrine of the Carbon Black case have little place and would be a heavy hand indeed on the future development of international commercial dealings by Americans. We cannot have trade and commerce in world markets and international waters exclusively on our terms, governed by our laws, and resolved in our courts. Forum-selection clauses have historically not been favored by American courts.... Many courts, federal and state, have declined to enforce such clauses on the ground that they were 'contrary to public policy,' or that their effect was to 'oust the jurisdiction' of the court. Although this view apparently still has considerable acceptance, other courts are tending to adopt a more hospitable attitude toward forum-selection clauses. This view, advanced in the well-reasoned dissenting opinion in the instant case, is that such clauses are prima facie valid and should be enforced unless enforcement is shown by the resisting party to be 'unreasonable' under the circumstances. We believe this is the correct doctrine to be followed by federal district courts sitting in admiralty.")

¹⁰⁶ *M/S Bremen*, 407 U.S. at 10, 92 S.Ct. at 1913.

¹⁰⁷ *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585, ----, 111 S.Ct. 1522, 1528, 113 L.Ed.2d 622 (1991); *M/S Bremen*, 407 U.S. at 12-13, 92 S.Ct. at 1914;

¹⁰⁸ *Id.* at 18, 92 S.Ct. at 1917

¹⁰⁹ *Id.* at 15, 92 S.Ct. at 1916.

¹¹⁰ See Robert A. Sedler, *Professor Juenger's Challenge to the Interest Analysis Approach to Choice-of-Law*, 23 UC Davis L Rev 865, 877 (1990).

¹¹¹ Hillman, *Cross-Border Investment, Conflict of Laws, and the Privatization of Securities Law*, 55-Aut Law & Contemp. Probs. 331, 343.

¹¹² *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 516, rehearing denied, 419 U.S. 885, 95 (1974).

¹¹³ *Richards v. Lloyd's of London*, 107 F.3d 1422 (9th 1997)

¹¹⁴ *Richards v. Lloyd's of London*, 135 F.3d 1289 (9th 1998) (Rehearing en banc)

¹¹⁵ See *Stamm v. Corporation of Lloy's*, 1997 WL 438773, p???? (casting doubt on *Roby v. Corporation of Lloyd's*, 996 F.2d 1353, which upheld the clause based on)

¹¹⁶ in *Richards v. Lloyd's of London*, 107 F.3d 1422 (9th Cir. 1997)

¹¹⁷ 1367(a) says that "Except as provided in subsections (b) and (c) or as expressly provided otherwise by Federal statute, in any civil action of which the district courts have original jurisdiction, the district courts shall have supplemental jurisdiction over all other claims that are so related to claims in the action within such original jurisdiction that they form part of the same case or controversy under Article III of the United States Constitution. Such supplemental jurisdiction shall include claims that involve the joinder or intervention of additional parties." 28 U.S.C.A. § 1367(a).

¹¹⁸ Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YLJ 2359, 2418-27 (1998) (discussing the desirability of global regulatory competition and the advantage of allowing issuers to choose which jurisdiction's securities laws will govern).

¹¹⁹ *Id.*

¹²⁰ *Id.*

¹²¹ See *Id.* ("The U.S. approach that adopts the procedural rules of the forum can have a significant impact on substantive outcomes because, in addition to class action mechanisms to aggregate individual claims not prevalent in other countries, U.S. procedure--including rules on discovery, pleading requirements, contingent fees, and the absence of a "loser pays" cost rule--are far more favorable to plaintiffs than those of foreign courts.")

¹²² Stephen Choi and Guzman, *International Cooperation: Portable Reciprocity: Rethinking the International Reach of Securities Regulation*, 71 SCALR 903, 915-916.

¹²³ See Romano, 107 YLJ 2359, footnote 220 (empirical study done by Shahrokh M. Saudagaran & Gary C. Biddle does not support the race-for-the-bottom hypothesis that the probability of a firm listing on a given foreign exchange is inversely related to the exchange's disclosure level when its disclosure level is higher than the disclosure level of the firm's domestic exchange). Contrast

¹²⁴ Although there is no direct evidence to support this theory, the legal risks may have also changed the original plans of Bank of China and China Construction Bank, the second and the third largest commercial

bank in China, to list in the New York Stock Exchange. One thing to be noted is that their change of mind happened after the class action was brought against China Life and Netease.com will make people wonder how much such decisions are influenced by it. Another possible explanation is Sarbanes-Oxley—but still, the risk of litigation is there. For more information, see Yue Gang, *Bank of China and China Construction Bank only chose Hong Kong*, available at <http://www.eobserver.com.cn/english/readnews.asp?ID=290>.

¹²⁵ Id at 915-916 (“In theory, countries may design efficient securities regulations through international cooperation that would be enforced globally. Parties engaging in securities fraud, for example, would find it difficult to escape enforcement under a perfect global regulatory regime. In practice, of course, the existing global regulatory regime is far from perfect. Although the SEC has met with some success in gaining cooperation from other countries regarding insider trading laws, international cooperation remains limited. Despite the facial success of the SEC's efforts, agreements between countries are often difficult and time consuming to obtain. Moreover, once agreements are signed, countries must expend resources monitoring compliance. For example, initial evidence on the insider trading laws instituted in Japan and Switzerland demonstrate less than vigorous enforcement. Over time, national regulatory bodies may take over the agreement, adding provisions and increasing the complexity of the regime to enhance the importance of the regulatory agencies”).

¹²⁶ Of course, for those with a strong belief in regulation competition, a uniform law is something to avoid.

¹²⁷ China's membership information could be found at WCISID's website, <http://www.worldbank.org/icsid/constate/c-states-en.htm>.

¹²⁸ See e.g., *Memorandum of Understanding with the China Securities Regulatory Commission*, available at http://www.osc.gov.on.ca/Regulation/Memoranda/mou_20030404_china-commission.jsp.

¹²⁹ Chairman Christopher Cox, *Speech by SEC Chairman: Remarks before the Securities Industries Association/Tsinghua University Conference*, at <http://www.sec.gov/news/speech/spch101805cc.htm>.