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United States Supreme Court Rejects "Extraterritorial" Application of the Securities Exchange Act: *Morrison v. National Australia Bank*

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The Supreme Court today handed down a sweeping victory for foreign businesses facing securities class actions in United States courts. In *Morrison v. National Australia Bank*, No. 08-1191, the Court ruled that "Foreign-Cubed" securities class actions—private actions brought on behalf of foreign purchasers of foreign companies' securities that were sold on foreign exchanges—may not be litigated in United States courts under Section 10(b) of the Securities Exchange Act.[1]

The Court rejected the fact-intensive "conduct" test, which the Second Circuit had used to determine whether claims based on a foreign transaction could be litigated under the U.S. securities laws. Instead, the Court adopted a bright-line "transactional test"—"whether the purchase or sale is made in the United States, or involves a security listed on a domestic exchange."

THE LONG-STANDING "CONDUCT" TEST

Before *Morrison*, the federal trial and appeals courts had long acknowledged that Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") "is silent as to its extraterritorial application." But rather than limit the scope of the statute to the United States, courts applied their "best judgment as to what Congress would have wished if these problems had occurred to it," and concluded that Congress did not intend "to allow the United States to be used as a base for manufacturing fraudulent security devices for export, even when these are peddled only to foreigners."

The result was a "conduct" test for extraterritoriality, under which a Foreign-Cubed purchaser had a right of action where the foreign issuer's "acts (or culpable failures to act) within the United States directly caused [his] losses." In creating this test, the Second Circuit "freely acknowledge[d] that if we were asked to point to language in the statutes, or even in the legislative history, that compelled these conclusions, we would be unable to respond." *See IIT v. Vencap, Ltd.*, 519 F.2d 1001 (2d Cir. 1975); *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974 (2d Cir. 1975).

Morrison was the first opportunity for the Second Circuit to consider the "conduct" test as applied to Foreign-Cubed plaintiffs after the Supreme Court's decisions in *F. Hoffmann-LaRoche Ltd. v. Empagran S.A.*, 542 U.S. 155 (2004), and *Microsoft v. AT&T Corp.*, 550 U.S. 437 (2007), which applied a presumption against extraterritoriality for federal statutes that were silent or ambiguous as to their extraterritorial reach—"a presumption that United States law governs domestically but does not rule the world." While the court of appeals again acknowledged that the Exchange Act is silent on its extraterritoriality, it declined to apply the presumption against extraterritoriality. Instead, the Second Circuit applied its long-standing "conduct" test, returning "to the underlying purpose of the anti-fraud provisions as a guide to discern whether Congress would have wished the precious resources of United States courts and law enforcement agencies to be

[1] Morrison & Foerster filed an amicus brief in support of respondents.

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devoted to [the claims of Foreign-Cubed plaintiffs].” The court concluded that the Foreign-Cubed plaintiffs had failed the “conduct” test due to the “lengthy chain of causation between the American contribution to the [alleged] misstatements and the harm to investors.”

THE SUPREME COURT’S DECISION

In rejecting the Second Circuit’s “conduct” test, the Supreme Court adopted a “transactional” test for the application of Section 10(b): “whether the purchase or sale is made in the United States, or involves a security listed on a domestic exchange.”

The Court reiterated that it is a “longstanding principle of American law that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States.” The Court recognized that the failure to apply this principle in Section 10(b) cases “has produced a collection of tests for divining what Congress would have wanted, complex in formulation and unpredictable in application.” The Court criticized the Second Circuit’s “conduct test” as “judicial-speculation-made-law” and suggested that its unpredictable results “demonstrate the wisdom of the presumption against extraterritoriality … in all cases.”

In concluding that Section 10(b) does not apply to transactions on foreign exchanges, the Court explained that “the focus of the Exchange Act is not upon where the deception originated, but upon purchases and sales of securities in the United States. Section 10(b) does not punish deceptive conduct, but only deceptive conduct ‘in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered’” (quoting 15 U.S.C. § 78j(b)). The Court stated: “We know of no one who thought that the Act was intended to ‘regulat[e]’ *foreign* securities exchanges—or indeed who even believed that under established principles of international law Congress had the power to do so.”

Finally, the Court expressed concern that the extraterritorial application of Section 10(b) to transactions on foreign exchanges would interfere with other nations’ ability to regulate their own markets. Moreover, the Court noted that the case-by-case conduct test that was urged by the plaintiffs and the United States government as amicus curiae would be difficult to administer and make United States courts open to burdensome class actions.

CONCLUSION

The Supreme Court’s decision to reject the “conduct” test and adopt a bright-line “transactional” test, which excludes Foreign-Cubed class actions from the United States courts, brings certainty to foreign issuers for their securities not traded on U.S. markets.

The proliferation of securities class actions in the United States has caused some foreign companies to withdraw from United States capital markets, and foreign companies have also threatened to retreat from doing business in the United States due to the unpredictable risk of securities litigation. Foreign companies are likely focused on this risk exposure more than ever after a multi-billion-dollar jury verdict was handed down this year in *In re Vivendi Universal S.A. Securities Litigation*, a class action brought in the Southern District of New York on behalf of French purchasers of Vivendi S.A. securities on the Paris Stock Exchange.

Today’s bright-line rule brings much-needed predictability to this area. It is also consistent with a principle of international comity—that other sovereign countries have a much stronger interest than the United States does in regulating securities transactions that take place on foreign markets.

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