CLIENT UPDATE

SECOND CIRCUIT FURTHER LIMITS SECURITIES CLAIMS BASED ON THE PURCHASE OF FOREIGN SECURITIES

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In a closely-watched decision in the securities class action arena, the Second Circuit in *City of Pontiac Policemen's and Firemen's Retirement System v. UBS AG*,[1] held that the antifraud provisions of Section 10(b) of the Exchange Act do not apply to purchases of foreign securities on a foreign exchange even where those securities are also listed on a United States exchange. The *UBS* decision represents a logical yet important extension of the Supreme Court's holding in *Morrison v. National Australia Bank, Ltd.*, 561 U.S. 247, 130 S. Ct. 2869 (2010) and eliminates an argument plaintiffs had tried to use as a partial end-run around the *Morrison* ruling.

THE *MORRISON* DECISION

The Supreme Court's *Morrison* decision involved a securities claim brought by foreign investors who purchased shares of the National Australia Bank on a foreign exchange in Australia—in other words, a "foreign cubed" claim in which the plaintiffs, the issuer, and the exchange were all non-U.S. persons or entities.[2] The Supreme Court held that such a claim could not be maintained because the transaction itself—the purchase of the security—took place outside the United States and Section 10(b) lacks extraterritorial reach.[3]

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1 No. 12–4355–cv, 2014 WL 1778041, at *3 (2d Cir. May 6, 2014).

2 *Morrison*, 130 S. Ct. at 2886 n.11.

3 *Id.* at 2884.

The *UBS* case presented not only a "foreign cubed" claim, with the twist that the foreign securities were dual-listed on the New York Stock Exchange, but also a "foreign squared" claim, in which a U.S.-based investor purchased the foreign security on the foreign exchange. *Morrison* did not specifically address the issue of dual-listing,[4] and the *UBS* plaintiffs attempted to exploit this perceived loophole in arguing that their claims were not precluded by the holding in *Morrison*.

THE *UBS* DECISION

The *UBS* plaintiffs argued that the purchase on any exchange of foreign securities that were cross-listed on the New York Stock Exchange ("NYSE") gives rise to liability under the United States securities laws because "U.S. exchange-registered securities are at issue" and, according to *Morrison*, Section 10(b) applies to "securities listed on domestic exchanges." Following the reasoning adopted by a handful of prior district court opinions in the Circuit, the Second Circuit rejected this "listing theory," finding that it suffered from at least two problems.[5] First, the transactional test specifically articulated by the Supreme Court was based on where the securities transaction itself took place, not on whether the security was also listed on an exchange in the United States. Second, the clear aim of *Morrison* was to limit (if not extinguish) the extraterritorial reach of Section 10(b).[6] The Second Circuit acknowledged that *Morrison* contained language that "taken in isolation" could support the plaintiffs' position but concluded that these "foreign cubed" claims were "irreconcilable" with *Morrison* as a whole. The Second Circuit noted that the Supreme Court focused on the location of the *securities transaction*, not the location of the exchange.[7]

The Second Circuit also rejected the "foreign squared" claims, which presented an issue of first impression. Applying the Supreme Court's statement in *Morrison* that the transactional test turned on "whether a purchase or sale is made in the United States," the Second Circuit concluded that a purchaser's location is not equivalent to the location of a transaction, and held that the placement of a buy order in the U.S. for a transaction executed on a foreign exchange is insufficient, standing alone, to support application of the U.S. securities laws to the transaction.[8] These conclusions fit neatly into the admonition of

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[4] The *Morrison* Court noted, but did not comment further on, the fact that National Australia Bank's American Depository Receipts, which entitled the holder to a certain number of the bank's shares, were listed on the NYSE. *Id.* at 2875.

[5] *City of Pontiac*, 2014 WL 1778041, at *3 (2d Cir. May 6, 2014).

[6] *See In re UBS Sec. Litig.*, No. 07 Civ. 11225(RJS), 2011 WL 4059356, at *5-6 (S.D.N.Y. Sept. 13, 2011).

[7] *City of Pontiac*, 2014 WL 1778041, at *3.

[8] *Id.* at *4.

Morrison that "*some* domestic activity" is clearly insufficient to overcome the presumption that a law does not apply outside the borders of the United States.[9]

THE IMPORTANCE OF THE DECISION

The Second Circuit's holding in *UBS* is a significant victory for corporations facing securities litigation claims involving transnational securities, particularly foreign issuers uncertain of the potential risks of dual-listing on U.S. exchanges. Previously, securities plaintiffs had pressed arguments based on the "listing theory" or the U.S. location of the purchaser of foreign securities, both efforts to avoid the effect of *Morrison* on their claims.[10] The Second Circuit has now made it clear that plaintiffs cannot avoid the limits of *Morrison* and expand the proposed class to include purchasers on foreign exchanges by relying on a "listing theory." We expect that other circuit courts, none of which have considered this issue to date, will adopt the Second Circuit's well-reasoned analysis.

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Please do not hesitate to contact us with any questions.

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[9] *Morrison*, 130 S. CT. at 2884.

[10] *E.g., In re Royal Bank of Scotland Grp., PLC Sec. Litig.*, 765 F. Supp. 327, 335-36 (S.D.N.Y. 2011) (collecting cases).