U.S. SUPREME COURT RESTRICTS FOREIGN INVESTORS' ACCESS TO U.S. SECURITIES LAWS IN *MORRISON V. NATIONAL AUSTRALIA BANK, LTD.* – WILL CONGRESS REINSTATE IT?

June 28, 2010

To Our Clients and Friends:

On June 24, 2010 the U.S. Supreme Court ruled that foreign nationals who purchase securities of a foreign issuer on a foreign stock exchange – so-called "F-Cubed" plaintiffs – may not pursue claims under U.S. securities laws, even in situations where other shareholders who purchase the same company's securities in the U.S. could pursue such claims. The decision, in *Morrison v. National Australia Bank, Ltd.,* is significant not only because it curtails such claims, but because it does so emphatically – closing the door of federal courts to any and all shareholders who do not purchase their shares on a U.S. stock exchange or otherwise buy or sell U.S.-registered securities. The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), expected to come before Congress this week for a final vote, however, carves out for the U.S. Securities and Exchange Commission ("SEC") an exception for extraterritorial jurisdiction, and could eventually lead to the nullification of *Morrison.*

THE *MORRISON* OPINIONS

Justice Antonin Scalia, writing for a majority of the court, took the view that nothing in the federal securities laws suggests that they were intended by Congress to apply outside of U.S. territory, continuing a line of recent Supreme Court cases emphasizing that U.S. laws are presumed not to apply extraterritorially unless Congress expresses an "affirmative intention" that is "clearly expressed." Compare *F. Hoffmann-Le Roche Ltd. v. Empagran, S.A.*, 542 U.S. 155 (2004) (limiting extraterritorial reach of Foreign Trade Antitrust Improvements Act) and *Microsoft Corp. v. AT&T Corp.*, 550 U.S. 437 (2007) (limiting extraterritorial reach of section of U.S. patent law). Justice Scalia added that the scope of the securities laws is statutorily limited to "transactions in securities listed on domestic exchanges, and domestic transactions in other securities to which §10(b) [of the Securities Exchange Act] applies."

The other members of the Court who participated in the ruling (Justice Sonia Sotomayor did not participate) agreed that the plaintiffs in this case should not be allowed to pursue their claims under federal securities laws. Concurring in the judgment, Justice John Paul Stevens, however, rejected the emphatic rule suggested by the majority and instead took the view that in other cases, where significant conduct in furtherance of a securities fraud may have taken place in the U.S. or where fraud committed elsewhere may have had an effect in the U.S., the federal securities laws should be available to aggrieved shareholders, even if some of those

shareholders are F-Cubed plaintiffs. The view espoused by Justice Stevens had prevailed, in one form or another, in the Courts of Appeals for roughly 40 years prior to yesterday's ruling. Justice Ruth Bader Ginsburg joined Justice Stevens in his concurring opinion. Justice Stephen Breyer wrote separately, also concurring in the judgment but finding Justice Scalia's "transactional test" unnecessary because the securities involved in this particular case were purchased on a foreign exchange and involved only foreign investors. For Justice Breyer, that was enough to dismiss the petitioner's complaint.

FACTUAL BACKGROUND AND PROCEDURAL HISTORY

National Australia Bank Limited ("NAB"), the largest bank in Australia, traded its shares on the Australian Stock Exchange and other foreign exchanges, and its American Depository Receipts ("ADRs") on the New York Stock Exchange. In February 1998, NAB bought HomeSide Lending, Inc., a mortgage servicing company based in Florida. From 1998 to 2001, NAB boasted about HomeSide's strong business in NAB's annual reports and in other public statements. In July 2001, however, NAB announced that it was writing down the value of HomeSide's assets by $450 million, and then again in September by another $1.75 billion.

The plaintiffs, three Australian citizens,[1] alleged that NAB, HomeSide and several individual defendants violated §§10(b) and 20(a) of the Exchange Act by manipulating HomeSide's financial models to make HomeSide's assets appear more valuable than they actually were. The plaintiffs represented a class of foreign shareholders who purchased NAB's shares outside the U.S. on foreign exchanges.

The district court granted the defendants' motion to dismiss for lack of subject-matter jurisdiction. The court found no subject-matter jurisdiction because, under the Second Circuit's well-established two-pronged "conduct" and "effects" tests, the acts committed in the U.S. were, "at most, a link in the chain of an alleged overall securities fraud scheme that culminated abroad."[2] The Second Circuit affirmed.

---

[1] *The district court dismissed the claims by Robert Morrison, the lone American plaintiff who purchased NAB's ADRs on the New York Stock Exchange, because he failed to allege damages. Morrison did not appeal.*

[2] *National Australia Bank Sec. Litig., No. 03 Civ. 6537 (BSJ), 2006 WL 3844465, at *8 (S.D.N.Y. 2006).*

THE EXTRATERRITORIAL REACH OF §10(b)

Although the Supreme Court affirmed the Second Circuit's ruling, it found that the Circuit Court erred in its analysis. The Supreme Court held that the extraterritorial reach of §10(b) was not a question of subject-matter jurisdiction, as the Second Circuit had determined, but rather, a merits question. Looking at the merits, Justice Scalia cited what he termed an established canon of statutory construction: "When a statute gives no clear indication of extraterritorial application, it has none."

Applying this canon, Justice Scalia rejected decades of jurisprudence developed in the Second Circuit and other Courts of Appeals – which had adopted "conduct" and "effects" tests for determining the validity of foreign-plaintiff claims – and concluded that it "produced a collection of tests for divining what Congress would have wanted, complex in formulation and unpredictable in application." Instead, Justice Scalia determined that nothing in the text of §10(b) or other parts of the Exchange Act gave a clear indication that Congress intended the law to have extraterritorial reach.

THE "TRANSACTIONAL TEST"

Justice Scalia also addressed an argument by the foreign plaintiffs in *Morrison* that they did not seek to apply the Exchange Act extraterritorially, but instead only wished to apply it based on Homeside's conduct in the U.S., which they claimed misled them in Australia and therefore gave rise to their claims. While acknowledging that "it is a rare case of prohibited extraterritorial application that lacks *all* contact with the territory of the United States," Justice Scalia nevertheless said that plaintiffs' claims did not arise under the Exchange Act. In what is likely to become the most important and far-reaching ruling of the case, he said that "only transactions in securities listed on domestic exchanges, and domestic transactions in other securities" fall within the scope of §10(b). In other words, because F-Cubed plaintiffs have not engaged in a domestic securities transaction, they do not and cannot have claims under the Exchange Act.

The advent of this new "transactional test" for securities law claims will have little impact on traditional class action cases affecting domestic issuers whose shares are not traded outside the U.S. Foreign private issuers, however, will henceforth only be subject to claims under U.S. securities laws to the extent they are brought by shareholders whose purchases took place in the U.S. This could reduce the class action litigation threat that has prompted some foreign issuers to question whether a U.S. listing is worth the potential litigation risks. At the same time, however, some foreign issuers, recognizing that this ruling effectively immunizes them from U.S. securities class action lawsuits so long as their securities are only traded offshore, may decide to stay away from U.S. capital markets.

In footnote 12 of his concurring opinion, Justice Stevens explicitly suggested that "[t]he Court's opinion does not … foreclose the [SEC] from bringing enforcement actions in additional circumstances, as no issue concerning the [SEC's] authority is presented in this case." The majority, however, did not appear to adopt this view. The "transactional test" is defined broadly as applying to all §10(b) actions, whether brought by private parties or the SEC. Justice Scalia did not restrict the language or analysis of any part of his opinion to private actions; rather, he referred to "Section 10(b)" or "the Exchange Act" as a whole.

CONGRESSIONAL ACTION THREATENS A REVERSAL

Notwithstanding the Court's ruling, it appears that Congress is poised to override *Morrison's* applicability to the SEC's enforcement actions, and has directed the SEC to study the potential effects of a more complete reversal of *Morrison* in connection with private damage actions. The Dodd-Frank Act, as approved by House and Senate conferees on Friday, June 25, 2010, one day after the *Morrison* ruling, contains a provision that extends the SEC's enforcement jurisdiction to cover significant steps in furtherance of a violation, even if the securities transaction occurred outside the U.S. It also covers foreign conduct that has a foreseeable substantial effect within the U.S. If the Dodd-Frank Act passes Congress with this provision intact, which it likely will, the Court's decision in *Morrison* should not apply to the SEC. The rule described by Justice Stevens, or something very much like it, is likely to prevail in future SEC actions.

The Dodd-Frank Act also requires the SEC to study the extent to which private rights of action under the antifraud provisions of the Exchange Act should be extended to cover the same extraterritorial jurisdiction granted to the SEC. The study must consider (i) the scope of such a private right of action; (ii) implications on international comity; (iii) the economic costs and benefits of extending a private right of action for transactional securities fraud; and (iv) whether a narrower extraterritorial standard should be adopted. The SEC must report its findings to Congress within 18 months after the Dodd-Frank Act's passage, and at that time, if Congress decides to adopt expanded jurisdictional provisions for private rights of action, the *Morrison* "transactional test" could be completely nullified.

Please feel free to contact us with any questions.

Colby A. Smith	Jonathan R. Tuttle	Edwin G. Schallert	Jeffrey S. Jacobson
+1 202 383 8124	+1 202 383 8095	+1 212 909 6295	+1 202 383 8247
casmith@debevoise.com	jrtuttle@debevoise.com	egschallert@debevoise.com	jsjacobson@debevoise.com