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Supreme Court Limits Availability of United States Courts to Securities Law Claims Brought by Foreign Purchasers of Securities of Foreign Companies

The United States federal securities laws have long offered investors more favorable protections, both substantive and procedural, than the laws in most other jurisdictions. These include not only substantive protections such as Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder, but also procedural advantages such as the ready availability of the class action and the absence of rules requiring that an unsuccessful plaintiff pay the attorneys' fees of a winning defendant. As a result, foreign plaintiffs and their counsel have attempted to bring securities law claims in the United States where possible, even if the securities at issue were those of foreign companies traded on foreign exchanges.

On June 24, 2010, the Supreme Court substantially limited the availability of United States courts to such claims, known as "F-cubed" lawsuits (foreign plaintiff, foreign issuer, foreign exchange), in *Morrison v. National Australia Bank Ltd.* In that case, Australian plaintiffs purchased ordinary shares of National Australia Bank ("National"), whose shares were traded on various foreign exchanges. National's shares were not traded on any United States exchange, although its American Depository Receipts ("ADRs") were traded on the New York Stock Exchange. In 2001, National announced large writedowns of the assets of a mortgage-servicer subsidiary headquartered in Florida. Plaintiffs sued National, its subsidiary, and three U.S. executives of the subsidiary in the Southern District of New York, alleging violations of Section 10(b). Plaintiffs sought to represent a class of foreign purchasers of National's ordinary shares.

The Supreme Court rejected plaintiffs' claim, applying a presumption that Congressional legislation is meant to apply only within the territorial jurisdiction of the United States unless a contrary intent is clearly expressed in the statute. The Court examined the text of Section 10(b) and the Exchange Act more generally, and found nothing to suggest they apply extraterritorially. Acknowledging that some of the allegedly fraudulent activity had occurred in the United States, the Court responded that the focus of the inquiry is not where the deception originated or where its effects were felt, but rather where the purchases and sales of securities took place, because Section 10(b) by its terms applies to fraud "in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered." It also noted that, contrary to the treatment of the issue in the lower courts, the issue was not one of subject matter jurisdiction but rather of statutory scope.

In applying this test of where the purchases and sales took place, the Supreme Court rejected a test that had long been applied by most federal courts of appeals, including the Second Circuit Court of Appeals. Those courts had looked to where the wrongful conduct took place and where its effects were felt. This test had proved difficult for courts to apply and led to unpredictable outcomes. Most notably, in the highly publicized Section 10(b) class action against Vivendi Universal—which resulted in a plaintiffs' verdict and potential multi-billion dollar liability in January of this year—the district court applied the now-rejected test to permit a class of foreign purchasers of the common stock of that French company on foreign exchanges to sue in New York, because the executives of the company were located in New York and had made certain alleged misrepresentations to U.S. analysts. This ruling will likely have to be revisited in light of the Supreme Court's decision.

The Supreme Court also rejected a test proposed by the Securities and Exchange Commission, which would have turned on whether the alleged fraud "involves significant conduct in the United States that is material to the fraud's success." Because the SEC itself frequently proceeds under Section 10(b), the Court's focus on whether there are purchases or sales on United States exchanges may limit the extraterritorial reach of the SEC in some cases as well.

The Court's ruling does not preclude all litigation against foreign companies under the United States securities laws, although the precise scope of extraterritoriality remains to be resolved in certain circumstances. Purchasers of ADRs of foreign companies on American exchanges likely will contend that, because their purchases took place on an American exchange, they have recourse to the U.S. courts under Section 10(b). American purchasers of securities of foreign companies on foreign exchanges will have more difficulty showing they meet the "purchase or sale" test. And while the opinion does not address the situation where securities are traded on both U.S. and foreign exchanges, it suggests that only those purchases or sales on U.S. exchanges will give rise to claims under Section 10(b); this issue, however, likely will be subject to future debate.

As in recent Supreme Court decisions, the Court made note of its ongoing concern over abusive securities law claims. The SEC suggested to the Court that extraterritorial coverage would serve the purpose of "preventing the United States from becoming a 'Barbary Coast' for malefactors perpetrating frauds in foreign markets." To this the Court responded: "While there is no reason to believe that the United States has become the Barbary Coast for those perpetrating frauds on foreign securities markets, some fear that it has become the Shangri-La of class-action litigation for lawyers representing those allegedly cheated in foreign securities markets."

Notwithstanding any open questions as to its scope, the Court's ruling in *Morrison* substantially reduces the exposure to claims under the U.S. securities laws of foreign issuers that do not list their shares on U.S. exchanges. The Court noted that its ruling would reduce the likelihood of conflict and interference with foreign countries' regulation of their own markets. F-cubed claims in the future more likely will be governed by the laws of the jurisdictions in which foreign issuers elect to list their shares.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to Charles E. Davidow ((202) 223-7380), Brad S. Karp ((212) 373-3316), Daniel J. Kramer ((212) 373-3020) or Richard A. Rosen ((212) 373-3305).