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Northern District of Illinois Applies *Morrison v. National Australia Bank Ltd.* in Ruling Against SEC

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The Northern District of Illinois recently handed down a decision that further interpreted the contours of the Supreme Court's 2010 decision in Morris*on v. National Australia Bank Ltd.*, which held that Section 10(b) of the Exchange Act is not extraterritorial. In *Securities and Exchange Commission v. Benger*, Magistrate Judge Jeffrey Cole granted a motion for partial summary judgment as to some claims against the defendants because the stock sales at issue were not "domestic transactions" as defined by *Morrison*.

In *Benger*, the SEC alleged that the defendants – a group of distribution and escrow agents based in the United States (the "Distribution Agents") – had violated Section 10(b) by engaging in an international "boiler room" scheme in which they took a 60 percent commission from foreign investors' proceeds without disclosing such commissions to the investors. The Distribution Agents retained sales agents in foreign countries to make cold calls primarily to the elderly in those countries, during which they employed high-pressure sales tactics, fraudulent misrepresentations and false identities to secure sales. One of the stocks being sold was Integrated Biodiesel Industries, Ltd. (IBI), which accounted for approximately 35 percent of the $44 million yielded in the scheme. IBI is a St. Vincent and Grenadines company with its principal place of business in Brazil.

The defendants moved for summary judgment as to the claims relating to IBI, arguing that Section 10(b) did not apply because "the issuers of the stock were foreign, the investors were foreign, and the stock sales transactions were foreign." The SEC, however, argued that the Distribution Agents were in the United States while aiding and abetting the fraud by putting together stock purchase agreements (SPAs) and receiving and distributing the proceeds.

"Domestic Transaction" Under *Morrison*

Because IBI shares had never been registered with the SEC or traded on any United States markets or exchanges, the ultimate question in the case was whether purchases of IBI were "domestic transactions" under *Morrison*. In cases regarding securities not registered on domestic exchanges, "the question under *Morrison* is where the stock purchase transaction occurred, not the locus of the bulk of the fraudulent activity." Judge Cole noted that *Morrison* "specifically rejected" the argument that Section 10(b) extends to cases in which "the fraud involves significant conduct in the United States that is material to the fraud's success."

Under the terms of the SPAs, IBI was not irrevocably bound by an offer to purchase shares until it accepted the investor's offer, which was received in Brazil from the defendants in the United States. The defendants had no authority to accept or reject an offer submitted by a potential investor. IBI would then issue a share certificate, send it to the defendants, who would send it to the foreign investor outside the United States.

The SEC argued that because the Distribution Agents were authorized to receive offers and send the certificates to investors on IBI's behalf, this activity operated as IBI's acceptance within the United States. The court rejected this argument, noting that the SPAs and escrow agreements said nothing about acceptance being contingent upon or effectuated by the defendants sending certificates to investors. Instead, "all they were doing was forwarding IBI's acceptance, which had occurred previously in Brazil." Thus, the Distribution Agents did not have the authority to accept the offer and it was only accepted outside of the United States.

While the court noted that "a lot of activity" occurred in the United States, "[t]he sale's only connection with the United States was the fact that IBI employed escrow agents in the United States as intermediaries between it and the investors." Ultimately, however, the contract was formed in Brazil because that was where all the acceptances occurred. Thus, the court reasoned that "[i]n the end, this

was a sale of shares in a foreign company to foreign investors." Based on that conclusion, the court granted the defendants' motion for partial summary judgment.

Impact of 2010 Dodd-Frank Act

Notably, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 included a provision that provides that Section 10(b) has extraterritorial reach in cases brought by the SEC and the Department of Justice (DOJ), even if the securities transaction occurs outside the United States and involves only foreign investors.[1] While the *Benger* court did not address this issue – presumably because the conduct at issue preceded enactment of the Dodd-Frank Act – the provision may contravene the *Morrison* and *Benger* holdings in similar cases brought by the SEC or DOJ addressing post-Dodd-Frank conduct.

If you have any questions regarding the Dodd-Frank Act, the Morrison or Benger cases, or this alert please contact the authors or members of our **SEC and White Collar Defense Practice Group**.

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1 Section 929p(b)(2) of Title IX of the Dodd-Frank Act provides jurisdiction over SEC and DOJ enforcement actions if the fraud involves: (1) conduct within the United States that constitutes a significant step in furtherance of the violation, even if the securities transaction occurs outside the United States and involved only foreign investors; or (2) conduct occurring outside the United States that has a foreseeable substantial effect in the United States.