The Dreaded U.S. Class Action Monster has Lost a Tooth:
A Unanimous[1] U.S. Supreme Court Limits Extraterritorial Application of Securities Law by Disallowing Foreign Cubed §10(b) Class Actions—
Morrison v. National Australia Bank Ltd., 561 U.S. ____ (2010)

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In a decision dated June 24, 2010,[3] the U.S. Supreme Court held that Section 10(b) of the Securities Exchange Act of 1934 does not provide a cause of action to foreign plaintiffs for misconduct in connection with securities traded on a foreign exchange. In this case, which involved securities not listed on a U.S. exchange and in which all aspects of the purchases complained of occurred outside the U.S., the Court rejected all of the Solicitor General's technical arguments, stressed the importance of the general presumption against extraterritoriality and held that the Exchange Act's focus is not on the place where the deception originated, but on purchases and sales of securities in the United States. Specifically, Section 10(b) applies only to transactions in securities listed on domestic exchanges and domestic transactions in other securities.

The shares of the Respondent, National Australia Bank Limited ("National"), are not traded on any U.S. exchange although its ADR's, which give rights to obtain such shares, are listed on the New York Stock Exchange. National bought HomeSide Lending, Inc., a mortgage servicing company, headquartered in Florida. National allegedly significantly overvalued HomeSide's assets in National's annual reports and other public documents. HomeSide's subsequent write-downs, explained as the result of a failure to anticipate the lowering of prevailing interest rates, were followed by substantial decreases in the prices of both National's stock and its ADRs. Senior executives of HomeSide had, however, allegedly manipulated their financial models intentionally to produce misleading valuations of their assets; and National was allegedly aware of the manipulations. The Petitioners, all Australians, purchased National stock before the write-downs. They sued National, HomeSide, and several officers of both companies in New York seeking to represent a class of foreign purchasers of National's stock who had purchased National's shares prior to the write-downs and had suffered financial losses as a result. Respondents moved to dismiss for lack of subject-matter jurisdiction[4] and for failure to state a claim.[5]

While recognizing that federal courts of appeal (in particular the Second Circuit) have developed a body of case law concerning extraterritorial application of laws in

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1 Justices Roberts, Kennedy, Thomas and Alito joined in Justice Scalia's opinion; Justice Breyer filed a concurring opinion and Justice Stevens, joined by Justice Ginsburg, filed a concurring opinion; Justice Sotomayor did not participate.

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3 *Morrison v. National Australia Bank Ltd.* 561 U.S. _____ (2010). The text of the opinion is available at: http://www.supremecourt.gov/opinions/09pdf/08-1191.pdf.

4 Under FRCP Rule 12(b)(1).

5 Under FRCP Rule 12(b)(6).

general – and §10(b) in particular – which has delineated certain tests[6] to determine Congress' intentions in this regard, the Court clearly rejected the prior case law on the grounds that these tests were difficult to apply and led to unpredictability, an unacceptable result in the Court's view. The majority specifically rejected the test proposed by Appellants: "a transnational securities fraud violates [§]10(b) when the fraud involves significant conduct in the United States that is material to the fraud's success."[7] The clear, dual transactional test announced by Justice Scalia will now replace those other tests, thereby eliminating extraterritorial application of Rule 10b-5 to foreign purchases and sales by foreign investors of securities of a foreign issuer. This decision should calm the fear that the U.S. "has become the Shangri-La of class-action litigation for lawyers representing those allegedly cheated in foreign securities markets."[8]

The Court began by citing a case concerning a claim for employment discrimination for the "longstanding" principle that "legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States,"[9] and went on to state that "when a statute gives no clear indication of an extraterritorial application, it has none."[10] As a result, at least according to Justice Stevens, private parties will now be foreclosed "from bringing §10(b) actions whenever the relevant securities were purchased or sold abroad and are not listed on a domestic exchange."[11]

This decision represents a reversal of a decades-long – albeit controversial - trend in the Federal Circuits.[12] The Court cited with approval a D.C. Circuit case holding that, rather than trying to divine "what 'Congress would have wished' if it had addressed the

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6 Such as whether the acts complained of had a substantial effect in the United States or on U.S. citizens (the "effects" test) , see *Schoenbaum v. Firstbrook*, 268 F. Supp. 385, 392 (1967) (citing *Ferraoli v. Cantor*, CCH Fed. Sec. L. Rep. ¶91615 (SDNY 1965) and *Kook v. Crang*, 182 F. Supp. 388, 390 (SDNY 1960) or whether the wrongful conduct occurred in the U.S. (the "conduct" test), see *SEC v. Berger*, 322 F.3d 187, 192-193 (CA2 2003), or a combination of the two *Itoba Ltd. V. Lep Group PLC*, 54 F. 3d 118, 122 (1995).

7 561 U.S. _____, (2010) (Slip opinion p. 21) citing Brief for United States as *Amicus Curiae* 16.

8 561 U.S. _____, (Slip opinion p. 21) citing Brief for Infineon Technologies AG as *Amicus Curiae* 1-2, 22-25; Brief for European Aeronautic Defence & Space Co. N.V. et al. as *Amici Curiae;* Brief for Securities Industry and Financial Markets Association et al. as *Amici Curiae*, 10-16; Coffee, *Securities Policeman to the World? The Cost of Global Class Actions*, N.Y.L.J. 5 (2008); S. Grant & D. Zilka, *The Current Role of Foreign Investors in Federal Securities Class Actions*, PLI CORPORATE LAW AND PRACTICE HANDBOOK SERIES, PLI Order No. 11072, pp. 15-16 (Sept.-Oct. 2007); Buxbaum, 46 COLUM. J. TRANSNAT'L L. 14, 38-41 (2007).

9 Under Title VII of the Civil Rights Acts, *EEOC v. Arabian American Oil Co.,* 499 U.S. 244, 248 (1991).

10 561 U.S. ___, (2010) (Slip opinion p. 6).

11 Concurring opinion of Stevens, J., 561 U.S.__, (2010) (Slip opinion, concurring opinion of Stevens, J. p.11).

12 See, *e.g. IIT, Int'l Inv. Trust v. Cornfeld*, 619 F. 2d 909 (CA2 1980); *IIT v. Vencap, Ltd*., 519 F. 2d 1001 (CA2 1975); *Bersch v. Drexel Fire-stone, Inc*., 519 F. 2d 974 (CA2 1975); *Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F. 2d 1326 (CA2 1972); Natalya Shnitser, *A Free Pass for Foreign Firms ? An assessment of SEC and Private Enforcement Against Foreign Issuers*, 119 YALE L.J. 1638 (2010), Hannah L. Buxbaum, *Multinational Class Actions Under Federal Securities Law: Managing Jurisdictional Conflict*, 46 COLUM. J. TRANSNAT'L L. 14, 39 (2007) and cases cited therein.

problem[, a] more natural inquiry might be what jurisdiction Congress in fact thought about and conferred."[13] As Justice Stevens points out in his concurring opinion, this statement summarily dismisses decades of case law and practice which recognized the judicial elaboration, primarily in the Federal Courts of Appeal of the Second Circuit (New York), the financial center of the United States, of §10(b) liability, tacitly approved by both Congress and the Securities Exchange Commission and generally assented to by the other Circuits.[14]

Whether this opinion is a reaction to international outrage at the extent of American class action practice, a reflection of Justice Scalia's restrictive view of statutory interpretation, or a result of the change in composition of the court since Judge Friendly's creation of the Second Circuit's "conduct and effects" test remains to be seen. But clearly change is afoot. At the very least, it would appear that, under the transactional test adopted by the majority, unless purchases or sales of a foreign issuer's securities occur in the U.S. or concern securities of a foreign issuer that are listed on a domestic U.S. exchange, the foreign issuer no longer faces the threat of exposure to claims under §10(b) of the Exchange Act. Perhaps, now, management of some foreign corporations with U.S. activities will sleep better having fewer potential American dragons to slay.

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13 *Zoelsch v. Arthur Andersen & Co.,* 824 F. 2d 27, 32 (1987) (Bork, J.).

14 Concurring opinion of Stevens, J., 561 U.S.__, (2010) (Slip opinion, concurring opinion of Stevens, J. p.5).