ALERTS AND UPDATES

U.S. Supreme Court Establishes "Transaction Test" to Determine Extraterritorial Reach of Section 10(b) of Exchange Act and SEC Rule 10b-5

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The Supreme Court's majority opinion in *Morrison v. National Australia Bank, Ltd*.[1] may be as significant for its "bright-line" approach to the presumption against the extraterritorial application of federal legislation as it may be for curbing foreign securities-fraud class actions in an era of increasing global transactions.

The opinion of the Court, penned by Justice Scalia, concluded that section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), and therefore derivatively SEC Rule 10b-5, applies only to the purchase or sale of a security listed on an American stock exchange or to the purchase or sale of a security in the United States. The Court rejected both the Second Circuit's view that the extraterritorial reach of section 10(b) was an issue of subject-matter jurisdiction and the Second Circuit's effects and conduct tests developed to determine jurisdiction over foreign securities transactions. The "effects test," which analyzed whether the alleged wrongful conduct had an effect on the United States or its citizens, and the "conduct test," which looked to whether the alleged wrongful conduct occurred in the United States, had been followed in large part by the other circuit courts of appeals.

The majority analysis is classically strict-constructionist, in an area of law that admittedly developed by way of judicial rule of decision. Justice Scalia reviewed the text of section 10(b) as well as the applicable definitions, purpose and purview of the Exchange Act, and compared this to the Securities Act of 1933 for any indicia of congressional intent that would override the presumption that section 10(b) was intended to apply only within the territory of the United States. He concluded that, since there was no affirmative indication in the Exchange Act that section 10(b) should be given extraterritorial effect, it primarily is concerned with domestic conditions and does not apply extraterritorially.

While Justice Stevens (joined by Justice Ginsberg) and Justice Breyer filed concurring opinions, no Justice dissented in the judgment. The plaintiffs were Australians who purported to represent a class of Australian purchasers. The lead defendant was an Australian national bank. The securities were purchased in Australia, and all were listed on only a few foreign exchanges. At oral argument, Justice Ginsberg commented that the case "ha[d] Australia written all over it"—a point Justice Stevens underscored in concurring with the Court's judgment. The lawsuit's link to the United States was National Australia Bank's purchase of HomeSide Lending, Inc., a Florida-headquartered mortgage-servicing company. The alleged fraud involved National Australia's allegedly inaccurate reports of HomeSide's financial success in National Australia's and HomeSide's annual reports and public statements.

Stevens' concurring opinion and the Solicitor General's Office advocated in favor of the Second Circuit's approach, noting that its test had been refined over several decades with the tacit approval of Congress and the U.S. Securities and Exchange Commission. Stevens opined that the text and history of section 10(b) were "famously opaque," and federal courts had been called on frequently to interpret its purview at Congress' invitation. He also questioned the transformation of the presumption against extraterritorial effect of federal statutes from a "flexible rule of thumb" to a "clear statement rule" and did not view the presumption as "fatal" to the Second Circuit's effects and conduct tests.

While the Court's decision was presented in the context of strict statutory construction, Justice Scalia hinted at policy reasons behind the analysis. Disputing the contention that the United States had become the "Barbary Coast" for perpetrating frauds, he acknowledged the possibility that it had become the "Shangri-La" for securities class actions brought for fraud in foreign markets.

For Further Information

If you have any questions about this *Alert*, please contact Charlotte E. Thomas, Richard L. Seabolt, Wayne A. Mack, any member of the Trial Practice Group or the attorney in the firm with whom you are regularly in contact.

Note

1. *Morrison v. Nat'l Austl. Bank Ltd*., 2010 U.S. LEXIS 5257 (U.S. June 24, 2010).