New York Law Journal
SERVING THE BENCH AND BAR SINCE 1888
WWW.NYLJ.COM
An ALM Publication
VOLUME 251—NO. 99
FRIDAY, MAY 23, 2014

Outside Counsel

Expert Analysis

Second Circuit Applies 'Morrison' To Reject 'Listing Theory'

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On May 5, 2014, the U.S. Court of Appeals for the Second Circuit decided *City of Pontiac v. UBS AG,*[1] affirming the dismissal of a securities fraud complaint against UBS and holding that the Supreme Court's decision in *Morrison v. National Australia Bank*[2] precludes claims under U.S. securities laws based on transactions on foreign exchanges, even if the underlying securities are also cross-listed on a U.S. exchange. The Supreme Court held in *Morrison* that the private right of action under Section 10(b) of the Exchange Act does not apply extraterritorially. In the years since, *Morrison's* practical application has been litigated extensively, with plaintiffs proposing various theories why *Morrison* permits federal securities claims based on transactions on foreign exchanges.

In *City of Pontiac*, the Second Circuit rejected claims brought by purchasers on foreign exchanges, holding that only purchasers on U.S. exchanges (or in domestic over-the-counter transactions) can assert Section 10(b) claims. The decision confirms that foreign issuers do not subject themselves to liability under U.S. securities laws for transactions on a foreign exchange by virtue of cross-listing their securities on U.S. exchanges.

Background

Before *Morrison*, most courts applied some variation of either a "conduct" test or an "effects" test (or both) to determine whether the anti-fraud provisions of the U.S. securities laws applied to foreign securities transactions.[3] Broadly speaking, this meant that Section 10(b) applied to transactions on foreign exchanges if either (1) the alleged fraud had a substantial effect in the United States or on U.S. citizens or (2) the alleged wrongful conduct occurred in the United States.[4] The Supreme Court's decision in *Morrison* dramatically altered this landscape. In *Morrison*—which for the first time presented to the Supreme Court the issue of extraterritorial application of the federal securities laws—the court considered so-called "foreign-cubed" claims: claims by (1) foreign purchasers of shares in (2) foreign issuers (3) purchased on a foreign exchange. The Supreme Court held that the Exchange Act did not apply extraterritorially and declined to adopt a conduct or effects test for determining the law's reach. Instead, the court adopted a "transactional test," under which Section 10(b) applies only to "[1] transactions in securities listed on domestic exchanges, and [2] domestic transactions in other securities."[5]

Based on the Supreme Court's clear directive that U.S. securities laws are not intended to regulate foreign exchanges, most observers assumed that *Morrison's* new transactional test categorically prohibited federal securities fraud suits based on securities transactions on foreign exchanges. But a number of plaintiffs have argued that both prongs of *Morrison's* transactional test left the door open for at least a subset of suits based on transactions on foreign exchanges.

First, under the "listing theory," plaintiffs argued that *Morrison's* ref-

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erence to "transactions in securities listed on domestic exchanges" means that transactions on foreign exchanges were subject to U.S. securities law if the underlying security was also cross-listed on a domestic exchange.[6] Second, based on *Morrison's* reference to "domestic transactions in other securities," "foreign-squared" plaintiffs—which are domestic purchasers of shares in (1) foreign issuers on (2) foreign exchanges—argued that despite having purchased on foreign exchanges, their purchases were nonetheless "domestic transactions" under *Morrison* because they placed their buy orders in the United States.[7] In *City of Pontiac*—the first post-*Morrison* appellate decision addressing either the "listing theory" or foreign-squared claims — the Second Circuit rejected both theories.

'City of Pontiac v. UBS'

In *City of Pontiac*, a group of foreign and domestic institutional investors brought a purported securities fraud class action against UBS and several UBS officers and directors alleging violations of Sections 10(b) and 20(a) of the Exchange Act in connection with purchases of UBS common stock listed on both the NYSE and foreign exchanges. The plaintiffs who purchased UBS shares on foreign exchanges argued that, under *Morrison*, the Exchange Act applied to all worldwide transactions in UBS shares because UBS common shares were also cross-listed on the NYSE. And the foreign-squared plaintiffs argued that, in any event, their purchases were "domestic transactions" under *Morrison*. The district court rejected both the listing theory and the foreign-squared claims, dismissing all claims based on transactions on foreign exchanges.[8] After the court subsequently dismissed the remaining domestic claims for failure to state a claim, the plaintiffs appealed.

The Second Circuit affirmed. In considering the listing theory, the court acknowledged that some language in *Morrison* "taken in isolation" might support application of Section 10(b) to foreign transactions in securities cross-listed on domestic exchanges. The court explained, however, that the listing theory is "irreconcilable with *Morrison* read as a whole." In particular, the court noted *Morrison's* transactional focus, including *Morrison's* reading that the Exchange Act focused on "purchases and sales of securities in the United States."[9] The court also noted that the fact that the defendant-issuer in *Morrison* had American Depositary Receipts listed on the NYSE did not affect the Supreme Court's analysis in *Morrison*.[10] As a result, the court held that "*Morrison* does not support the application of §10(b)…to claims by a foreign purchaser of foreign-issued shares on a foreign exchange simply because those shares are also on a domestic exchange."[11]

In rejecting the foreign-squared claims, the Second Circuit first confirmed that "a purchaser's citizenship or residency does not affect where a transaction occurs."[12] The court went on to explain that the place where the purchase order was made is only one of several factors to consider in determining the location of a transaction under *Morrison*. The fact that an order to purchase shares on a foreign exchange is placed domestically is not sufficient to bring the transaction into Section 10(b)'s reach. As a result, the court held that foreign-squared claims are not domestic transactions under *Morrison*.

While district courts had consistently rejected claims under the listing theory and foreign-squared claims as inconsistent with *Morrison*, the Second Circuit's decision in *City of Pontiac* is the first appellate decision addressing—and rejecting—those novel theories of liability. The decision in *City of Pontiac* should give foreign issuers (and their officers and directors) greater comfort that they may access U.S. capital markets without subjecting themselves to liability under U.S. securities laws for transactions on foreign exchanges.

1. *City of Pontiac Policemen's and Firemen's Retirement System v. UBS AG*, 12-4355-cv (2d Cir. May 6, 2014).
2. *Morrison v. National Australia Bank*, 561 U.S. 247 (2010).
3. See, e.g., *S.E.C. v. Berger*, 322 F.3d 187, 192-93 (2d Cir. 2003); *Zoelsch v. Arthur Andersen & Co.*, 824 F.2d 27, 31-32 (D.C. Cir. 1987).
4. See *Berger*, 322 F.3d at 192-93.
5. Id. at 267.
6. See, e.g., *In re Alstom SA Sec. Litig.*, 741 F.Supp.2d 469, 472 (S.D.N.Y. 2010) (dismissing claims brought under the "listing" theory); *In re Royal Bank of Scot. Grp. PLC Sec. Litig.*, 765 F.Supp.2d 327, 336 (S.D.N.Y. 2011) (same); *In re Infineon Technologies AG Sec. Litig.*, No. 04 Civ. 4156, 2011 WL 7121006 (N.D. Cal. Mar. 17, 2011) (same).
7. See, e.g., *Plumbers' Union Local No. 12 Pension Fund v. Swiss Reinsurance Co.*, 753 F.Supp.2d 166, 178 (S.D.N.Y. 2010); *In re Royal Bank of Scot.*, 765 F.Supp.2d at 337; *Cornwell v. Credit Suisse Grp.*, 729 F.Supp.2d 620, 624 (S.D.N.Y. 2010); *In re Merkin & BDO Seidman Sec. Litig.*, No. 08 Civ. 10922, 2011 WL 4435873, at *9 n.10 (SDNY Sept. 23, 2011).
8. *In re UBS Sec. Litig.*, No. 07 Civ. 11225 (RJS), 2011 WL 4059356, at *4-*8 (S.D.N.Y. Sept. 13, 2011).
9. *City of Pontiac*, Op. at 12 (quoting Morrison, 561 U.S. at 266).
10. *City of Pontiac*, Op. at 13.
11. Id. at 14.
12. Id. at 15 (quoting *Absolute Activist Value Master Fund Ltd. v. Ficeto*, 677 F.3d 60, 69 (2d Cir. 2010)).