Second Circuit Holds That *Morrison* Precludes Securities Fraud Claims for Cross-listed Securities

This week, the US Court of Appeals for the Second Circuit issued an important ruling restricting the courts' authority over securities fraud cases involving securities listed on foreign exchanges – even if those securities are cross-listed on exchanges in the United States. *See City of Pontiac Policeman's and Firemen's Retirement System v. UBS A.G.*[1] The case followed the landmark US Supreme Court decision in *Morrison v. National Australian Bank Ltd*,[2] in which (upsetting years of lower court precedent), the Court held that the civil fraud provision of the Securities Exchange Act of 1934 ("Section 10(b)") does not apply to claims by *foreign* investors against *foreign* issuers to recover losses from purchases on *foreign* securities exchanges (so-called "foreign-cubed" claims). The *Morrison* Court applied a "presumption against extraterritoriality" to reach this result, requiring a clear indication of congressional intent to allow a federal statute to apply to conduct outside the United States. Finding that Congress made no such clear statement with respect to Section 10(b), the Court held that Section 10(b) is only available for "transactions in securities listed on domestic exchanges and domestic transactions in other securities."

In a case of first impression, the Second Circuit considered whether the *Morrison* bar on the extraterritorial application of Section 10(b) applied (1) to securities purchased on foreign exchanges that are cross-listed in the United States, and (2) to purchases made by US investors of foreign securities listed on foreign exchanges (so-called "foreign squared" transactions).

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[1] *City of Pontiac Policeman's and Firemen's Retirement System v. UBS A.G.*, No. 12-4335-cv, 2014 WL 1778041 (2d Cir. May 6, 2014).
[2] 561 U.S. 247 (2010).

Morrison[3]

In *Morrison,* the Supreme Court considered the extraterritorial reach of US securities laws in the context of a "foreign-cubed" class action – "foreign plaintiffs suing foreign and American defendants for misconduct in connection with securities traded on foreign exchanges." To address this question, the Supreme Court relied on the longstanding principle that "when a statute gives no clear indication of an extraterritorial application, it has none." The Court then determined that Congress provided "no affirmative indication in the Exchange Act that Section 10(b) applies extraterritorially," and therefore held that "it does not."

In so holding, the Court rejected the less stringent "conduct and effects" test developed by lower courts in the decades preceding *Morrison*. Under that test, federal courts generally treated extraterritoriality as a question of jurisdiction and concluded that they possessed the power to decide a securities-fraud claim if the plaintiff alleged either: (1) that a significant portion of the allegedly fraudulent conduct occurred in the United States or (2) that a significant effect of the conduct was felt in the United States. In the wake of *Morrison*, courts have foregone that complex analysis and simply barred Section 10(b) claims unless they involved a purchase or sale in the United States or a purchase or sale anywhere of a security listed on a domestic exchange.

City of Pontiac

In *City of Pontiac*, the Second Circuit considered whether the bar on the extraterritorial application of US securities laws precludes (1) claims arising out of foreign-issued securities purchased on foreign exchanges, even if the securities are also cross-listed on a domestic exchange, and (2) claims arising out of "foreign-squared" transactions involving foreign securities, foreign exchanges, and US purchasers. Plaintiffs, a group of foreign and US-based institutional investors, alleged that UBS, a Swiss bank, certain of its officers and directors, and members of its underwriting syndicate violated Sections 10(b) and 20(a) of the Exchange Act by making fraudulent statements in connection with the issuance of "ordinary shares" of UBS.

The trial court dismissed the claims of three foreign investors and one domestic investor who "purchased their UBS (foreign-issued) ordinary shares on a foreign exchange."[4] Those plaintiffs appealed, arguing that the *Morrison* bar is limited to claims arising out of securities not listed on a domestic exchange at all, and not to cross-listed securities. Under this "listing theory," plaintiffs argued that *Morrison* should be read to permit claims based on purchases of cross-listed securities because such securities are "listed on a domestic exchange," even if the purchases at issue were made on a foreign exchange.

The Second Circuit rejected plaintiffs' "'listing theory'" as "irreconcilable with *Morrison* read as a whole." The court observed that *Morrison* emphasized the location of the securities transaction at issue – i.e., where the securities were purchased – and not "the location of an exchange where the security *may* be dually listed." Thus, the technicality that shares are cross-listed should not subject a wholly foreign transaction to the civil fraud provision of the Exchange Act. The Second Circuit also noted that the shares at issue in *Morrison* were also traded via American Depositary Receipts listed on the NYSE and thus were similar to the cross-listed UBS shares. The Second Circuit concluded that "*Morrison* does not support the application of § 10(b) of the Exchange Act to claims by a foreign purchaser of foreign issued shares on a foreign exchange simply because those shares are also listed on a domestic exchange."

As for the "foreign-squared" claim, the US-based plaintiff asserted that it had placed a "buy order" for the shares in the United States and thus had made an actionable "purchase . . . of [a] security in the United States." The Second Circuit rejected this argument based on its own precedent in *Absolute Activist Value Master Fund Ltd. v. Ficeto*, which held that a "securities transaction is domestic [for purposes of *Morrison*] when the parties incur irrevocable liability to carry out the transaction within the United Sates or when title is passed within the United States." The Second Circuit held that the mere allegation that the

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[3] For further discussion of *Morrison*, *see* Clifford Chance June 2010 Client Memorandum, "F-Cubed Gets an F Grade from US Supreme Court."
[4] 2014 WL 1778041, at *1.

purchaser placed a "buy order" in the United States was insufficient to establish that a party incurred irrevocable liability within the United States.

Conclusion

It remains to be seen if the Supreme Court will examine the Second Circuit's decision in *City of Pontiac*. For the time being, however, the plaintiffs' effort to subject foreign issuers to civil suit under US securities law merely because the securities are also listed on US exchanges has failed. The *City of Pontiac* decision gives foreign issuers greater certainty that cross-listing their shares on US exchanges will not subject them to liability to civil plaintiffs for claims involving shares listed on foreign exchanges. The Second Circuit's rejection of "foreign squared" liability similarly limits the risk that foreign issuers may be subject to liability under US securities laws merely because buy orders are placed in the United States.

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