Approximately six months ago, the United States Supreme Court in *Morrison v. National Australia Bank Ltd.* changed the paradigm for extraterritorial application of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"). The Supreme Court jettisoned the long-standing conduct and effects test adopted by federal appeals courts, and replaced it with a new transactional test: "whether the purchase or sale [of a security] is made in the United States, or involves a security listed on a domestic exchange." Lower courts have applied Morrison's presumption against extraterritorial application of U.S. federal law to factual circumstances and legal claims not at issue in *Morrison*. Although Congress quickly moved to reassert the primacy of the conduct and effects test for actions brought by the Securities and Exchange Commission ("SEC"), it did not reverse the effect of *Morrison* on private lawsuits. Moreover, the SEC has asserted that *Morrison* does not affect its ability to bring enforcement actions due to specific provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") that it claims were intended to overturn *Morrison*.

**Morrison**

In *Morrison*, the Supreme Court considered whether the antifraud provision of the Exchange Act, Section 10(b), "provide[d] a cause of action to foreign plaintiffs suing foreign (and American) defendants for misconduct in connection with securities traded on foreign exchanges," the so-called "f-cubed" scenario. Holding that the appellate court had erroneously considered the extraterritorial reach of Section 10(b) as a question of subject matter jurisdiction, the Court explained that the question of "what conduct Section 10(b) prohibits" is a "merits question" requiring analysis of the scope of the Exchange Act itself. To interpret Section 10(b) of the Exchange Act, the Court relied on the principle that "when a statute gives no clear indication of an extraterritorial application, it has none." Because Congress provided no affirmative indication in the Exchange Act that Section 10(b) applies extraterritorially, the Court held that the statute did not.

**Cases Following Morrison**

In the wake of *Morrison*, plaintiffs in numerous cases argued that the Court's ruling limiting the extraterritorial impact of the Exchange Act was confined to cases involving foreign plaintiffs and transactions with little or no relation to the United States, limiting *Morrison* to the "f-cubed" facts of *Morrison* itself. For example, following *Morrison*, plaintiffs seized upon the phrase "whether the...

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purchase or sale is made in the United States” to argue that Morrison did not cover purchases made by U.S. investors, or made from the U.S. by U.S. brokers. Other plaintiffs cited the Court’s use of the phrase “involves a security listed on a domestic exchange” to argue that Morrison did not apply to claims related to securities listed on a foreign exchange if the company at issue also had shares listed on a domestic U.S. exchange. Courts to date have consistently rejected these arguments as an attempt to reinstate the conduct and effects test,2 and as an overly-technical reading of Morrison.3 As a result, the lower courts have uniformly interpreted Morrison to apply to the “f-squared” situation in which there are foreign defendants and foreign exchanges, but American plaintiffs. Not all courts stopped there, however. The following three cases push the boundaries of Morrison even further than the “f-squared” factual scenarios.

- **American Depository Receipts: In re Societe Generale Sec. Litig., No. 08-Civ-2495 (RMB) 2010 WL 3910286 (S.D.N.Y. Sept. 29, 2010)**

In Societe Generale, domestic plaintiffs brought claims against a French company whose stock was traded on the Euronext Paris stock exchange, and some of its current and former officers, directors and employees, for alleged violations of Section 10(b) of the Exchange Act, Rule 10b-5, and Section 20(a) of the Exchange Act. One of the plaintiffs held Societe Generale American Depository Receipts (“ADRs”), traded on the over-the-counter market in New York. In analyzing the claim of the ADR-holder, the Court observed that “a trade in ADRs is considered to be a predominantly foreign securities transaction” and that the ADRs at issue “were not traded on an official American securities exchange.” Having thus characterized the purchase of the ADRs as essentially a foreign exchange transaction, the Court held that the claims based on ADR transactions fell outside of the scope of Section 10(b).


Elliott Associates involved a group of global hedge funds, some of which were organized under the laws of foreign jurisdictions, but all of which were managed in the United States. The funds entered into securities-based swap agreements that referenced the share price of Volkswagen (“VW”), which had shares that traded on a German exchange. These swaps generated gains for the plaintiffs when the price of VW shares fell, and losses for the plaintiffs when the price of VW shares increased. The funds sued Porsche Automobil Holding SE (“Porsche”), another German automobile maker, and two of its executive officers for allegedly causing a dramatic rise in VW stock prices by buying nearly all the freely-traded voting shares of VW as part of a secret plan to take over the company.

Noting that Section 10(b) applies with full force to securities-based swap agreements, and that the VW-linked swap agreements were not listed on a domestic U.S. exchange, the Court focused on whether the VW-linked swap agreements constituted “domestic transactions in other securities” under Morrison. The Court stated that the “nature of the reference security must play a role in determining whether a transnational swap agreement may be afforded the protection of §10(b).” Because the swaps “were the functional equivalent of trading the underlying VW shares on a German exchange,” the Court held that “the economic reality is that Plaintiffs' swap agreements are essentially ‘transactions conducted upon foreign exchanges and markets,’ and not ‘domestic transactions’ that merit the protection of §10(b).”


In Royal Bank of Scotland (“RBS”) Group, a district court applied Morrison for the first time to exchange offer and rights issuance claims brought pursuant to Sections 11, 12(a)(2), and 15 of the Securities Act of 1933 (“Securities Act”). Disregarding plaintiffs’ arguments that they purchased the foreign listed shares in the United States and that RBS listed...
and registered American Depository Shares on the New York Stock Exchange, the Court focused instead on the country of listing of the actual shares. The Court concluded that “the idea that a foreign company is subject to U.S. securities laws everywhere it conducts foreign transactions merely because it has ‘listed’ some securities in the United States is simply contrary to the spirit of Morrison.” It also observed that the complaint lacked any allegation that the purchase of RBS ordinary shares under the exchange offer took place in the United States, or that the rights issue claim related to a U.S. public offering or a domestic securities transaction. As a result, the Court dismissed all of the plaintiffs' claims relating to transactions in ordinary shares.

The Impact of Morrison on SEC Enforcement Actions

Congress passed the Dodd-Frank Act less than a month after the Morrison decision. Section 929P(b) of the Act includes the following language with regard to the antifraud provisions of the Securities Act, the Exchange Act, and the Investment Advisers Act of 1940:

The district courts of the United States and the United States courts of any Territory shall have jurisdiction of an action or proceeding brought or instituted by the Commission or the United States alleging a violation … involving –

(1) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors; or

(2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States. 4

Representative Paul Kanjorski, sponsor of the Dodd-Frank Act, explained that the purpose of 929P(b) "is to make clear that in actions and proceedings brought by the SEC or the Justice Department, the specified provisions … may have extraterritorial application … irrespective of whether the securities are traded on a domestic exchange or the transactions occur in the United States, when the conduct within the United States is significant or when conduct outside the United States has a foreseeable substantial effect within the United States." 5

On October 25, 2010, the SEC issued a release emphasizing its belief that "the Dodd-Frank Act largely codified the long-standing appellate court interpretation of the law that had existed prior to the Supreme Court's decision in Morrison by setting forth an expansive conducts and effects test, and providing that the inquiry is one of subject matter jurisdiction." 6 Subsequently, in connection with a lawsuit against former Goldman Sachs employee Fabrice Tourre, the SEC stated in a footnote to its brief that Section 929P of the Dodd-Frank Act "effectively overruled Morrison by codifying the Second Circuit's long-standing conduct and effects test (which Morrison had repudiated) for civil enforcement actions brought by the SEC." 7

Moreover, SEC staff members (speaking in their personal capacity) have echoed the Commission's position in public appearances. Some commentators have questioned whether the SEC's interpretation of Section 929P(b) will be upheld by the courts, explaining that in deciding Morrison, the Court defined the question of extraterritorial application of Section 10(b) of the Exchange Act as a merits question, not a subject matter jurisdiction question. As a result, these commentators say the congressional "fix" contained in Section 929P of the Dodd-Frank Act did not actually overrule the Morrison holding, which involved the scope of the Exchange Act itself.

Conclusion

District courts have interpreted *Morrison* to exclude from the scope of the Exchange Act’s antifraud provisions transactions involving foreign-listed securities regardless of whether those transactions involved U.S. components or U.S. parties. The full impact of *Morrison* on U.S. securities law has yet to be seen, given the variety of transactions, statutory and regulatory regimes, and activity in question. But, if other lower courts take their lead from *Societe Generale, Elliott Associates* and *Royal Bank of Scotland Group*, foreign defendants will have gained substantial immunity from private suit under U.S. securities law over securities transactions that occur outside the United States – at least for now. It remains to be determined whether courts of appeal will affirm the lower courts' broad reading of *Morrison*. Also, the SEC, as directed by the Dodd-Frank Act, has requested public comment as to whether the conduct and effects test should be reinstated through new legislation for private suits relating to transnational securities transactions. The SEC is to report its view to Congress by January 2012. Finally, defendants remain subject to U.S. regulatory proceedings concerning transnational securities transactions because the SEC has interpreted Section 929P of the Dodd-Frank Act to allow it to prosecute transnational securities fraud that satisfies a reformulated version of the conduct and effects test. A court has yet to interpret Section 929P of the Dodd-Frank Act against the background of *Morrison*. The success of this interpretation remains to be seen.