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# *Morrison v. National Australia Bank Ltd.* – The U.S. Supreme Court Confirms that Section 10(b) of the Securities Exchange Act Does Not Apply Extraterritorially & Dismisses the Claims of "F-Cubed" Plaintiffs

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The Supreme Court's June 24, 2010, opinion in *Morrison v. National Australia Bank Ltd.*, 561 U.S. __ (2010), has narrowed dramatically the scope of Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 promulgated thereunder.

**Summary of the Court's Opinion.**

- The Court confirmed that Section 10(b) does not apply extraterritorially. In so doing, it rejected decades of jurisprudence in the lower federal courts that had previously permitted so-called "f-cubed" securities class actions – namely, foreign plaintiffs suing a foreign issuer for alleged violations of United States securities laws based upon transactions on a foreign stock exchange – in United States courts if there were *conduct* or *effects* in the United States. Such suits will no longer be possible.

- In place of that jurisprudence, the Supreme Court established a new, *transactional* test for determining when recourse to Section 10(b) will be available to investors: "Section 10(b) reaches the use of a manipulative or deceptive device or contrivance **only** in connection with the purchase or sale of **a security listed on an American stock exchange**, and the purchase or sale of any other security **in the United States**." A plaintiff who cannot satisfy either of those criteria will have no claim under Section 10(b) or Rule 10b-5, as a matter of law.

- In formulating this new test, the Court indicated that the extraterritorial reach of Section 10(b) is not a function of the subject-matter jurisdiction of federal courts – as some lower federal courts had previously held – but is instead a "merits question", determined by the scope of Section 10(b) itself.

- Finally, in a part of its opinion that will have broader application, the Court reaffirmed the "presumption against extraterritoriality" that applies when interpreting statutes – namely, that "[w]hen a statute gives no clear indication of an extraterritorial application, it has none."

**The Court's Reasoning.**

The Court's opinion begins with a strongly-worded critique of the "unpredictable and inconsistent application of § 10(b) to transnational cases" by the lower federal courts. Before *Morrison*, courts routinely applied two tests for subject-matter jurisdiction to determine whether investors who had purchased securities listed on foreign exchanges could bring suit under Section 10(b) in the United States: (a) the "conduct test", which required the wrongful conduct to have occurred in the United States; and (b) the "effects test", which required the wrongful conduct to have had a substantial effect in the United States or upon United States citizens. The Supreme Court criticized those tests as lacking "a textual or even extratextual basis", as being "not easy to administer", and for "produc[ing] a proliferation of

vaguely related variations". But even more fundamentally, the Court criticized the lower courts for ignoring the "longstanding principle of American law 'that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States'". After analyzing the statute, the Court found that "there is no affirmative indication in the Exchange Act that § 10(b) applies extraterritorially, and we therefore conclude that it does not."

The Court's new, *transactional* test – limiting the application of Section 10(b) to situations where "the purchase or sale is made in the United States, or involves a security listed on a domestic exchange" – conforms with this more restricted view regarding the extraterritorial application of Section 10(b). As the Court observed, the test also recognizes and respects the ability of "foreign countries [to] regulate their domestic securities exchanges and securities transactions occurring within their territorial jurisdiction". Numerous foreign countries – including the United Kingdom, France and Australia – submitted *amicus* briefs to the Court "complain[ing] of the interference with foreign securities regulation that application of § 10(b) abroad would produce".[1]

Finally, the Court dismissed the concern that its holding would allow fraud involving foreign securities to be committed in the United States with impunity. The Solicitor General filed an *amicus* brief arguing that the United States could become the "Barbary Coast" of securities fraud if the Exchange Act were interpreted not to apply extraterritorially. The Court found no support for that dire prediction and noted that, even if it had, it could not extend the statute beyond the meaning of its text simply to serve "admirable purposes". In any event, the Court observed that a countervailing proposition might also be true: "[S]ome fear that [the United States] has become the Shangri-La of class-action litigation for lawyers representing those allegedly cheated in foreign securities markets."

**Implications of the Decision.**

By clearly barring "f-cubed" lawsuits, *Morrison* has cut short a growing trend in recent years in which plaintiffs' lawyers have attempted to use the class action mechanism to seek large recoveries on behalf of foreign plaintiffs with no connection to the United States. As Justice Stevens wrote with respect to *Morrison* in his concurring opinion, "this case has Australia written all over it." But the Court's decision does more than prohibit "f-cubed" lawsuits. Even United States plaintiffs who purchased or sold securities listed on a foreign exchange can no longer bring suit in this jurisdiction under Section 10(b). Moreover, unless changed by Congressional action,[2] this new test applies equally to potential enforcement actions by United States regulators, such as the SEC.

We expect litigation, however, in the lower courts regarding the scope of transactions covered by the phrase "domestic transactions in other securities" – the second part of the Court's *transactional* test. We also expect that foreign issuers may grow increasingly wary of listing on a United States exchange in the wake of *Morrison*. Further, plaintiffs who previously would have brought suit under Section 10(b) may now turn to state courts and assert state-law claims, to the extent such claims are not precluded by the Securities Litigation Uniform Standards Act of 1998 (SLUSA), or to foreign courts and foreign law.

*Morrison* may also have a significant impact outside securities fraud cases. The "presumption against extraterritoriality" when construing statutes has now been decisively reaffirmed by the Court. Indeed, as Justice Stevens observed in criticizing the Court's opinion, *Morrison* "seeks to transform the presumption from a flexible rule of thumb into something more like a clear statement rule". That presents an opportunity for multinational defendants to challenge the extraterritorial application of other statutes – like the Racketeer Influenced and Corrupt Organizations Act (RICO) – that are also silent as to their application to conduct abroad.

*This memorandum relates to general information only and does not constitute legal advice. Facts and circumstances vary. We make no undertaking to advise recipients of any legal changes or developments*.

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[1] Cravath represented the United Kingdom in the filing of its *amicus* brief.

[2] Included in the current version of the proposed Dodd-Frank Wall Street Reform and Consumer Protection Act is a provision that would give district courts "subject-matter jurisdiction" over actions or proceedings brought by the SEC or the United States to enforce the antifraud provisions of the United States securities laws if (a) significant steps were taken in the United States in furtherance of the violation or (b) the violation involved conduct occurring outside the United States that had a foreseeable substantial effect within the United States. The proposed provision – which basically tracks the old "conduct" and "effects" tests – does not apply to private securities fraud suits. That proposal may be flawed, however, in light of the Court's holding that the extraterritorial reach of Section 10(b) is not a function of the subject-matter jurisdiction of federal courts but instead a "merits question". If enacted, the Act would also require the SEC to study whether the "conduct" and "effects" tests should be made applicable to private suits.