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Expert Analysis

Federal Courts Apply 'Morrison' Expansively

The U.S. Supreme Court's ruling last term in *Morrison v. National Australia Bank*, which dismissed a securities fraud action against a non-U.S. issuer of securities registered on a non-U.S. exchange, has received a very warm welcome from judges in federal district courts.¹ Courts have read the *Morrison* holding expansively, dismissing a surprising number of lawsuits brought in the U.S. against foreign issuers, based on the holding in *Morrison* that §10(b) of the Exchange Act applies only when the securities at issue are traded on a U.S. exchange or purchased in the U.S.

Just one month after *Morrison* came down, a judge in federal court in Manhattan danced gleefully on the grave of the old standard. Judge Victor Marrero observed that the Supreme Court had unceremoniously "trashed" the U.S. Court of Appeals for the Second Circuit's "conduct and effects" test. Rejecting the effort by class-action lawyers to read *Morrison* narrowly, Judge Marrero stated that he was "not convinced that the Supreme Court designed *Morrison* to be squeezed, as in spandex, only into the factual strait jacket of its holding."

He concluded that the Second Circuit test had taken "a great fall," and that the plaintiffs' "law horses" could not "put the pieces together again." Even the Second Circuit has embraced the new bright-line standard, applying it outside the securities context to dismiss a RICO action alleging corporate misdeeds by Russian mobsters.²

The steady stream of decisions applying *Morrison* has provided answers to questions

By
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not dealt with directly in the *Morrison* opinion. Clearly, "F-cubed" actions, involving purchases by a non-U.S. person of securities of foreign issuers traded only on a foreign exchange, can no longer be brought under §10(b) of the Exchange Act. But what about an "F-squared" case, where the purchaser resides in the U.S.? What should courts do with American Depositary Receipts, where the ADR trades on an exchange in the U.S.? And what

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if the securities are not listed on an exchange but rather are purchased in private transactions?

The news so far is good for non-U.S. issuers unhappy about facing lawsuits in the U.S. alleging violations of U.S. laws.

'F-Squared' Transactions

After *Morrison*, the most worrisome scenario for foreign issuers involved U.S. shareholders who had acquired stock traded only on a non-U.S. exchange, e.g., in the country where the non-U.S. issuer was headquartered. Two decisions involving putative class actions brought against Swiss companies impacted by the implosion in U.S. residential mortgages (one being Judge

Marrero's decision discussed above) bode well for foreign issuers on this point. The named plaintiffs in these actions, *Cornwell v. Credit Suisse Group*³ and *Plumbers' Union Local No. 12 Pension Fund v. Swiss Reinsurance Co.*,⁴ were U.S. residents who had placed orders in the U.S. to buy stock in Swiss companies. Prior to *Morrison*, the complaints in these actions would likely have survived motions to dismiss since the "effects" of the issuers' alleged misstatements were felt in the U.S.

In *Cornwell*, Judge Marrero called the *Morrison* holding "a new bright-line transactional rule, embodying the clarity, simplicity, certainty and consistency that the tests from the Second and other circuits lacked." There is no carve-out, he ruled, to allow suits by U.S. purchasers of non-U.S. securities traded only on a foreign exchange. The holding in *Morrison*, he reasoned, recognized that American securities laws could be incompatible with foreign laws regulating securities transactions.

Two months later, Judge John G. Koeltl, followed Judge Marrero's lead. In *Plumbers' Union*, Judge Koeltl ruled that a purchase does not necessarily occur when and where the purchaser places a buy order. In *Plumbers' Union*, the named plaintiff had decided to purchase Swiss Reinsurance Company shares in Chicago, and its purchase orders were placed electronically by traders located in Chicago. The orders were then electronically routed by the traders through electronic connections to a number of brokers who matched the buy orders with sell orders.

The shares were ultimately purchased on the SWX Stock Exchange. Stock market transactions in Swiss Re common stock during the class period were executed, cleared and settled on a trading platform that was a subsidiary of SX Swiss Exchange based in London. Concerned, like Judge Marrero, over the interference with foreign

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securities regulation, Judge Koeltl ruled that the placement of an electronic order by an investor located in the U.S. does not subject securities traded on an exchange to §10(b).

In other contexts, federal judges have come to the same conclusion. In *re Société Générale Securities Litigation* involved a putative class action based on the Jerome Kerviel scandal.⁵ Judge Richard M. Berman dismissed fraud claims by two U.S. plaintiffs who had placed their orders to buy shares of the French issuer from the U.S. In September, Judge Marrero dismissed claims that had been pending since August 2003 following years of discovery, principally in France, and in *In re Alstom SA Securities Litigation*, Judge Marrero dismissed the claims of Americans who had purchased their stock on the Premier Marche of Euronext Paris, because the purchases were initiated in the U.S.⁶ (The decision does not deal with ADRs, discussed below, or shares purchased directly from the French issuer.)

An early decision involving the appointment of a lead plaintiff, *Stackhouse v. Toyota Motor Co.*, makes the same point: “because the actual transaction takes place on the foreign exchange, the purchaser or seller has figuratively traveled to that exchange—presumably via a foreign broker—to complete the transaction.”⁷ These courts agree: the happenstance of a U.S. resident placing a buy order to buy stock on a foreign exchange does not give them a claim against the issuer based on §10(b).

ADRs/ADSs

Prospects are less bright for issuers when U.S. investors have purchased by means of ADRs or ADSs. At this early stage, judges have not formed a view as to whether such investors can sue a foreign issuer under §10(b).

Judge Berman, in his *Société Générale* opinion, came out on the side of the foreign issuer. The ADRs owned by plaintiffs were not listed on an “official American securities exchange,” but instead in a “less formal market.” The opinion states broadly that “trade in ADRs is considered to be a ‘predominantly foreign securities transaction’” and that §10(b) is therefore inapplicable.

Other courts have not taken this position. In *Stackhouse*, the court allowed the purchaser of ADSs to serve as lead plaintiff (while ruling out much larger shareholders who bought on

a foreign exchange, as discussed above). But clearly the stakes have gone down after *Morrison* for foreign issuers with ADRs in the U.S. however. The lead plaintiff in *Stackhouse* had a loss of only \$250,000 on its ADS purchases, compared with a loss of up to \$17 million from other securities.

One question left open in *Morrison* is whether the registration and listing of shares on the NYSE to facilitate the registration and trading of ADRs satisfies the requirement that shares be listed on a U.S. exchange. If they do, any foreign issuer with ADRs in the U.S. would face exposure under §10(b), regardless of whether their securities were purchased in the form of ADRs or on a foreign exchange. Class action lawyers putting forward this reading of *Morrison* have not succeeded. For example, in *Alstom*, Judge Marrero explained why he was not persuaded by this overly technical reading of the decision, which effectively guts the Supreme Court’s holding.

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However, this technical point is all that will preserve a multi-billion verdict in a pre-*Morrison* class action, *In re Vivendi Univ., S.A., Securities Litigation*.⁸ In a post-verdict brief, plaintiffs presented the court with the cover page of a Form 20-F, stating that Vivendi’s shares were “registered” with the NYSE. Plaintiffs argued that, as a result of this registration on a U.S. exchange, non-U.S. purchasers could bring a fraud action based on their purchase of shares of a non-U.S. issuer even if they did not buy their shares on the NYSE. However, as pointed out by a commentator,⁹ the shares of National Australia Bank, at issue in *Morrison*, were also “registered” on the NYSE on account of U.S.-traded ADRs. *Morrison* would seem to be indistinguishable from *Vivendi*.

Private Transactions

Largely foreign transactions not involving securities purchases or sales executed on a foreign exchange present a more complex application of the *Morrison* transaction test, as

Judge Marrero noted in yet another of *Morrison* opinions, *Anwar v. Fairfield Greenwich Ltd.*¹⁰ A Madoff-related case, *Anwar* involves investors in non-U.S. funds that funneled investments to Bernie Madoff. Seeking to have the claims of these investors dismissed, the defense argued that a number of the administrative tasks associated with purchasing shares in the offshore funds occurred outside the U.S. Plaintiffs countered that they bought their shares in New York, when their subscription agreements were accepted by the funds, where the funds had an office and where much of their executive staff was concentrated. Judge Marrero declined to rule on the issue, stating that he needed a more developed factual record.

The few decided cases involving private transactions are encouraging. In *In re Banco Santander Securities-Optimal Litigation*, a Florida judge, Paul C. Huck, dismissed claims based on off-shore purchases in “off-shore Bahamian investment funds closed to United States investors.”¹¹ The judge noted that the funds were registered in the Bahamas “and the Plaintiffs purposefully went off-shore to invest.” The judge rejected a creative argument that plaintiffs had intended to buy securities in the U.S.

The same judge had occasion to expand on his point about subjective intent a week later, in *Quail Cruises Ship Management Ltd. v. Agencia de Viagens CVC Tur Limitada*.¹² The plaintiff asserted that even though an agreement was signed in duplicate in Spain and Uruguay, it had intended a closing to take place in the offices of a Miami law firm. But sending the documents to Miami did not satisfy *Morrison*, which would lose its teeth if “parties could elect United States securities law merely by designating the law offices of one of the parties’ counsel, located in the United States, as the place of closing the transaction when the transaction otherwise has no relation to the United States.”¹³

Regulation S

The SEC’s lawsuit against Fabrice Tourre, the Goldman Sachs employee charged with fraud in connection with the offer and sale of a CDO, was filed in April 2010, before *Morrison*, and before the Dodd-Frank Act basically restored the conduct-and-effects test for SEC actions (but not private actions).¹⁴ In this litigated action, the SEC finds itself in the same position as private

plaintiffs with respect to the extraterritorial application of §10(b), since the conduct at issue occurred in 2007, and Dodd-Frank is not retroactive.

On the basis of *Morrison*, Mr. Tourre has moved for a judgment on the pleadings, which identified only a German bank based in Dusseldorf¹⁵ as the purchaser of the CDO. He argued that the German bank chose, for its own regulatory, tax, or other reasons, to invest in the notes outside the U.S. The offering circular, he pointed out, states that Goldman is “offering the documents outside the United States to non-U.S. persons in off-shore transactions in reliance on Regulation S.”¹⁶

The SEC, with its reputation clearly at stake in its high-profile, controversial case against Mr. Tourre, originally stood by its original complaint, but has now been granted leave to amend its complaint.¹⁷ Before requesting leave to replead, the SEC had argued that numerous circumstances demonstrated that the German bank’s purchase took place in the United States, including that Goldman is a U.S. broker-dealer, headquartered in New York, where Mr. Tourre worked. It was sufficient, according to the SEC, that Mr. Tourre was in the U.S. when he offered an investment in the CDO to the German bank. In the SEC’s view, the “offer” of securities from the U.S. confers jurisdiction under the Securities Act of 1933, and the “sale” of securities (required for §10(b)) encompasses the “entire selling process.”

Mr. Tourre’s position is that the SEC not only ignores *Morrison*’s rejection of the conduct-and-effects test but also destroys the insulation afforded to foreign issuers by Regulation S, which provides for an exemption from registration under the 1933 Act for “offers and sales outside the United States.”

The SEC would read Regulation S narrowly, as relating only to the registration requirement, and not to antifraud or other provisions of the federal securities laws, relying on a statement to that effect in the SEC’s preliminary notes to Regulation S (“For the purposes only of §5 of the [1933] Act, the terms offer, offer to sell, sell, sale, and offer to buy shall be deemed to include offers and sales that occur within the United States and shall be deemed not to include offers and sales that occur outside the United States”). However, the SEC’s own statement

in the Regulation S release appears to be the only support for the SEC’s argument. The only case cited in the SEC’s brief on this point, is a Supreme Court opinion from 1969 dealing with the merger of insurance companies. *SEC v. National Securities Inc.*, 393 U.S. 453 (1969).

Moreover, as Mr. Tourre pointed out in his reply brief, Regulation S was promulgated years ago, in the context of the expansive extraterritorial jurisdiction widely accepted by courts before *Morrison*. Now that the conduct-and-effects test is no longer valid, Mr. Tourre maintains that the SEC needs to provide a principled explanation, and not just its own say-so, as to why a “foreign” transaction under Regulation S can be a domestic transaction under *Morrison*.

It remains to be seen how the SEC will buttress its case factually in its amended complaint (which must be filed by Nov. 22) and how the judge hearing the Tourre case, Judge Barbara S. Jones, will rule on this novel—and significant—issue should Mr. Tourre renew his motion for a judgment on the pleadings (which was dismissed without prejudice in the order granting the SEC leave to replead). If she rules against the SEC on the basis of *Morrison*, the SEC will lose face, but its enforcement program will not suffer. For all conduct occurring after the enactment of Dodd-Frank, the SEC can resume bringing cases based on largely foreign transactions. Indeed, in its recent Report of Investigation concerning Moody’s, the SEC conceded as much.¹⁸

If, on the other hand, Judge Jones sides with the SEC, the decision will be detrimental not just to Mr. Tourre, but to all foreign issuers hoping for certainty from *Morrison*’s strict, bright-line rule. A victory for the SEC would cast doubt on the usefulness of using Regulation S to structure transactions to take place outside the U.S. as a means of deterring U.S.-based class actions.



1. *Morrison v. Nat’l Australia Bank*, 130 S. Ct. 2869, 177 L. Ed. 2d 535 (2010).

2. *Norex Petroleum Ltd. v. Acces Indus.*, No. 04-CV-4553, 2010 WL 3749281 (2d Cir. Sept. 28, 2010).

3. *Cornwell v. Credit Suisse Grp.*, No. 08-CV-3758, 2010 WL 3069597 (SDNY July 27, 2010).

4. *Plumbers’ Union Local No. 12 Pension Fund v. Swiss Reinsurance Co.*, No. 08-CV-1958, 2010 WL 3860397 (SDNY Oct. 4, 2010).

5. *In re Société Générale Sec. Litig.*, No. 08-CV-2495, 2010 WL

3910286 (SDNY Sept. 29, 2010).

6. *In re Alstom SA Sec. Litig.*, No. 03-CV-6595, 2010 WL 3718863 (SDNY Sept. 14, 2010).

7. *Stackhouse v. Toyota Motor Co.*, No. 10-CV-0922, 2010 WL 3377409 (C.D. Cal. July 16, 2010).

8. *In re Vivendi Univ., S.A., Sec. Litig.*, No. 02-CV-5571 (SDNY filed July 18, 2002).

9. George T. Conway, “Postscript to ‘*Morrison v. National Australia Bank*,’” NYLJ, Oct. 14, 2010, at 5.

10. *Anwar v. Fairfield Greenwich Ltd.*, No. 09-CV-0118, 2010 WL 3341636 (SDNY Aug. 18, 2010).

11. *In re Banco Santander Securities-Optimal Litig.*, No. 09-MD-02073, 2010 WL 3036990 (S.D. Fla. July 30, 2010).

12. *Quail Cruises Ship Management Ltd. v. Agencia de Viagens CVC Tur Limitada*, No. 09-CV-23248, 2010 WL 311998 (S.D. Fla. Aug. 6, 2010).

13. But see *SEC v. Credit Bancorp*, No. 09-CV-11395, 2010 WL 3825739 (SDNY Sept. 30, 2010) (*Morrison* satisfied in SEC suit against a New Jersey man who marketed and sold investments in a non-U.S. investment vehicle to U.S. residents, and sending agreements to U.S. residents and receiving stock certificates trading on U.S. exchanges to be used as collateral for their purported investments.)

14. The Dodd-Frank Act amends both the Securities Act and the Exchange Act to authorize the SEC to prosecute defendants: (1) whose conduct within the U.S. constitutes significant steps in furtherance of securities frauds, even if the transaction occurs outside the U.S. and involves only foreign investors, or (2) whose fraudulent conduct occurring outside the U.S. has a foreseeable substantial effect within the U.S.

15. Brief of Fabrice Tourre, *SEC v. Goldman, Sachs & Co.*, (SDNY Sept. 20, 2010) (No. 10-CV-3220).

16. Reply Brief of Fabrice Tourre, *SEC v. Goldman, Sachs & Co.*, No. 10-CV-3220 (SDNY Oct. 25, 2010).

17. Brief of SEC, *SEC v. Goldman, Sachs & Co.*, (SDNY Oct. 13, 2010) (No. 10-CV-3220).

18. The SEC stated that it was not bringing an enforcement action against Moody’s involving securities arranged by European banks and marketed in Europe in 2007, “[b]ecause of uncertainty regarding a jurisdictional nexus to the United States.” The passage of Dodd-Frank would, the SEC stated, give federal courts jurisdiction in cases involving significant U.S.-based conduct “even if the securities transaction occurs outside the United States and involves only foreigners.” See Report of Investigation Pursuant to §21(a) of the Securities Exchange Act of 1934: Moody’s Investors Service Inc., Securities Exchange Act Release No. 62802, at 4 (Aug. 31, 2010).