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United States Supreme Court Limits Extraterritorial Reach Of Private Federal Securities Claims

In *Morrison v. National Australia Bank Ltd.*, 2010 WL 2518523 (U.S. Jun. 24, 2010), the United States Supreme Court held that domestic courts lack jurisdiction over claims brought by private citizens pursuant to Section 10(b) of Securities Exchange Act of 1934 ("Exchange Act'), 15 U.S.C. § 78j(b), and Securities & Exchange Commission Rule 10b-5, 17 C.F.R. § 240.10b-5, against corporations whose stock is traded exclusively in foreign exchanges. The decision, written by Justice Scalia on behalf of a five justice majority, departs from decades of precedent from the United States Courts of Appeals that allowed such claims to be brought when substantial aspects of the misconduct occurred in the United States or when the misconduct had a substantial effect on U.S. investors.

Defendant National Australia Bank, Ltd. ("National") is headquartered in Australia. Its "ordinary shares" are traded exclusively on non-U.S. stock exchanges. In 1998, National purchased defendant HomeSide Lending, Inc. ("HomeSide"), a mortgage servicing company headquartered in Florida. From 1998-2001, National touted the success of HomeSide. In 2001, however, National announced significant write downs in HomeSide's assets. Plaintiffs — all Australians, who sought to represent a class comprised solely of foreign investors — brought suit against National, HomeSide, and certain executive officers (including some operating out of Florida), alleging that HomeSide manipulated its financial models to make the company's mortgage servicing rights appear more valuable than they really were. Plaintiffs originally brought suit in the United States District Court for the Southern District of New York, alleging a violation of Section 10(b) and Rule 10b-5. Defendants moved to dismiss for lack of subject matter jurisdiction under Federal Rule of Civil Procedure 12(b)(1) and for failure to state a claim under Rule 12(b)(6). The district court granted the motion under Rule 12(b)(1), finding that the court had no jurisdiction because the misconduct that occurred in the US was "at most, a link in the chain of an alleged overall securities fraud scheme that culminated abroad." *In re National Australia Bank Sec. Litig.*,2006 WL 3844465 (S.D.N.Y. Oct. 25, 2006). The United States Court of Appeals for the Second Circuit affirmed on similar grounds. *Morrison v. National Australia Bank Ltd.*, 547 F.3d 167 (2d Cir. 2008).

The test applied by the district court and the Second Circuit, which grew out of Second Circuit precedent dating back to 1968, focused on whether misconduct by a foreign issuer either (1) had some effect on the US securities markets or investors or (2) significantly occurred in the United States. If either or a combination of these conditions was met, courts in the Second Circuit would permit claims under Section 10(b) to be

brought against foreign issuers (and their officers and directors) in federal court. The other Courts of Appeals, without exception, deferred to the Second Circuit's "preeminence in the field of securities law" and adopted similar formulations of the test.

The Supreme Court affirmed, but held that the Second Circuit nonetheless erred in its analysis. As Justice Scalia observed, the test adopted by the Courts of Appeals did not have its origins in the text of Section 10(b) or Rule 10b-5, neither of which expressly extended the federal courts' jurisdiction to transactions involving foreign issuers. Instead, the test grew out of more general attempts by the federal courts (led by the Second Circuit) to discern the intent of the 1934 legislature when enacting the Exchange Act. In the Opinion, Justice Scalia criticized the Courts of Appeal for attempting such analysis, holding that when a statute is silent on the question of extraterritorial application, "the presumption against extraterritoriality operates to limit that provision to its terms."

The Court held that "it is in our view only transactions in securities listed on domestic exchanges, and domestic transactions in other securities, to which § 10(b) applies." The Court reasoned that Section 10(b) could not encompass private claims against foreign issuers — even when those claims arose out of misconduct that occurred primarily in the United States or that affected the price of United States traded securities — because Section 10(b) focused not on punishing deceptive conduct, but on punishing deceptive conduct "in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered."

In *Morrison*, the Supreme Court upends nearly half a century of settled precedent in the Courts of Appeals in order to limit the scope of private securities claims pursuant to Section 10(b). (As the concurrence notes, and the majority does not dispute, the decision may not apply to claims brought by the U.S. government.) Of course, the private right of action under Section 10(b) and Rule 10b-5 is itself a judicially created right that exists without express textual basis in the Exchange Act. While Justice Scalia does acknowledge Supreme Court precedent confirming the existence of a private right of action under Section 10(b) and Rule 10b-5, in a footnote he signals that, to the extent aspects of the private right of action have been recognized only by the lower courts, the Supreme Court now stands ready to limit them. Therefore, though *Morrison*'s holding primarily is of note to foreign issuers, its analysis may prove useful for domestic defendants who seek further limits on the private right of action under Section 10(b) and Rule 10b-5.

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