ARNOLD & PORTER LLP

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US SUPREME COURT GRANTS *CERTIORARI* TO REVIEW FOREIGN-CUBED SECURITIES TRANSACTION CASE DESPITE SOLICITOR GENERAL'S OPPOSING VIEW

On November 30, 2009, the US Supreme Court granted *certiorari* to review the transnational securities fraud case of *Morrison* v. *National Australia Bank*. This comes on the heels of the US Solicitor General's brief filed on October 27, 2009, on behalf of the United States as *amicus curiae*, arguing that the petition for *writ of certiorari* should be denied. The *Morrison* case, which has been the subject of previous advisories by Arnold & Porter LLP,[1] involved a so-called "foreign-cubed" securities transaction—a transaction where (1) a foreign plaintiff is suing; (2) a foreign issuer in a US court for violations of US securities laws based on securities transactions; in (3) a foreign country. The plaintiffs in the case had appealed the Second Circuit Court of Appeal's decision to the US Supreme Court in response to the Second Circuit affirming the district court's dismissal of the plaintiffs' suit for lack of subject matter jurisdiction. The Second Circuit concluded that dismissal of the suit was proper because the "heart of the fraud" lay outside of the United States. The Second Circuit, however, refused to adopt a bright-line rule that barred these types of cases, holding instead that the decision as to whether subject matter jurisdiction exists should continue to be made on a case-by-case basis. In her brief, the Solicitor General agreed that the plaintiffs' case should have been dismissed and argued that the petition for *writ of certiorari* should be denied. Despite the Solicitor General's position, the US Supreme Court granted the petition for *writ of certiorari*.

In *Morrison*, the plaintiffs alleged that the defendants, an Australian parent company, its wholly-owned Florida-based subsidiary, and individual officers of the two companies, engaged in a transnational securities fraud in violation of Section 10(b) of the Securities Exchange Act of 1934, as amended (the Exchange Act) and Rule 10b-5 promulgated thereunder. The plaintiffs alleged that they were harmed after the Florida subsidiary provided false accounting figures to the foreign parent and the foreign parent incorporated that false information into its financial reports and other public statements. The plaintiffs then purchased stock in the foreign parent

1 "Second Circuit Rejects Bar On 'Foreign-Cubed' Securities Lawsuits," *available at:* http://www.arnoldporter.com/resources/documents/CA_SecondCircuitRejectsBarOnForeign-CubedSecuritiesLawsuits_102908.pdf; and The Eleventh Circuit Finds Subject Matter Jurisdiction in 'Foreign-Cubed' Securities Lawsuit," *available at:* http://www.arnoldporter.com/resources/documents/Advisory_ForeignCubedSecuritiesTransaction11thCircuitClientAdvisory_091109.pdf.

Brussels
+32 (0)2 290 7800

Denver
+1 303.863.1000

London
+44 (0)20 7786 6100

Los Angeles
+1 213.243.4000

New York
+1 212.715.1000

Northern Virginia
+1 703.720.7000

San Francisco
+1 415.356.3000

Washington, DC
+1 202.942.5000

that was at prices that were inflated by the misstatements, causing the price of the plaintiffs' stock to fall when the misstatements were exposed.[2]

The Second Circuit Court of Appeals relied on two rationales in holding that the plaintiffs' claims should be dismissed. First, the court stated that the conduct that occurred in the United States did not constitute the "heart of the fraud" and the action and inaction taken by the Australian parent company was significantly more central to the fraud than the manipulation of the numbers in Florida. Second, the court reasoned that the chain of causation between the contribution to the misstatements made from the United States and the harm to investors was too tenuous.

In her brief filed with the US Supreme Court, the Solicitor General argued that the court correctly concluded that the plaintiffs' private suit should not go forward. The Solicitor General also stated that even though the appellate courts have not been entirely uniform in their analysis of Section 10(b)'s application to transnational securities frauds, there has been no indication that any other circuit would have allowed plaintiffs' suit to proceed. In a footnote, the Solicitor General also noted that Congress is currently considering a legislative proposal that would address the extraterritorial reach of the antifraud provisions of the Federal securities laws as part of the Investor Protection Act of 2009.[3] The Solicitor General reasoned that the possibility that Congress would address this issue in the near future, provided an additional reason for the US Supreme Court to deny plaintiffs' *writ of certiorari*.

The Solicitor General argued, however, that the first ground cited by the Second Circuit of Appeals—the "heart of the fraud" analysis—was erroneous. The Solicitor General noted that "[a]s business transactions and fraudulent schemes become more and more internationally dispersed, cases are increasingly likely to arise in which no single country can meaningfully be described as the 'heart' of the fraud." The Solicitor General feared that if all countries interpreted their securities laws using the "heart of the fraud" approach outlined by the Second Circuit, then perpetrators may be able to escape liability in every jurisdiction. The Solicitor General argued that Section 10(b)'s coverage should not be limited to transnational frauds predominated by US conduct, but rather, Section 10(b) should apply in situations where a scheme involves significant conduct within the United States that is material to the fraud's success. Based on this analysis, the Solicitor General argued that the conduct of the US subsidiary and its officers within the United States "was not peripheral or merely preparatory, but was an integral component of the overall scheme" and thus within the scope of Section 10(b)'s substantive prohibition.

However, the tenuous connection between the actions in the United States and the actual harm to investors provided the basis for the Solicitor General to conclude that the plaintiffs were not entitled to invoke an implied private right of action under Section 10(b). In every private Section 10(b) cause of action, the plaintiff must allege a connection between the plaintiff's injury and the defendant's misconduct. The Solicitor General stated that when a foreign plaintiff in a private Section 10(b) action alleges that he or she was injured outside of the United States by transnational securities fraud, the plaintiff should be required to prove that his or her loss resulted directly from the component of the scheme that occurred in the United States. The Solicitor General argued that in the *Morrison* case, the link between the US subsidiary's alleged false statements and the ultimate harm to the plaintiffs was too indirect to support liability in a private suit. The Solicitor General noted that when the Australian parent company incorporated the false numbers into its financial reports and other public statements, the parent company's personnel were not acting under the direction

2 For a more detailed description of the facts of the Morrison case, please see our previous advisory at: http://www.arnoldporter.com/resources/documents/CA_SecondCircuitRejectsBarOnForeignCubedSecuritiesLawsuits_102908.pdf.

3 Section 215 of the Investor Protection Act of 2009, as proposed, would provide that the district courts of the United States have jurisdiction over violations of the antifraud provisions of the Exchange Act, the Securities Act of 1933, and the Investment Advisers Act of 1940 that involve a transnational fraud if there is "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."

and control of the US subsidiary but rather were exercising independent judgment as officers of the Australian parent corporation.

In reaching her conclusion that the plaintiffs' petition for *certiorari* should be denied, the Solicitor General also highlighted the fact that the plaintiffs had not identified any decision indicating that another court of appeals would have allowed their private suit to go forward. Therefore, the Solicitor General reasoned that it was unnecessary for the US Supreme Court to provide a final ruling when there was not direct conflict among the circuits. The Solicitor General noted that while the approaches of the various circuit courts that have addressed the transnational scope of Section 10(b) have not been uniform, the differences among the circuits have not been that drastic either. Generally, the circuits have agreed that private Section 10(b) suits may proceed if the conduct within the United States is a "significant" or "substantial" part of the fraudulent scheme and the conduct within the United States "directly causes" the harm to the plaintiff.

Despite the fact that the Solicitor General submitted a brief that was strongly in favor of denying the plaintiffs' petition for *writ of certiorari*, the US Supreme Court appears to have rejected the Solicitor General's analysis in granting plaintiffs' petition. Although, as the Solicitor General noted, the proposed legislation contained in the Investor Protection Act of 2009 directly addresses the transnational scope of the federal securities laws, it appears that the US Supreme Court is interested in sharing its own view as to the proper reach of those laws.

We hope that you had found this advisory useful. If you have additional questions, please contact your Arnold & Porter attorney or:

Stewart D. Aaron
+1 212.715.1114
Stewart.Aaron@aporter.com

Lauren R. Bittman
+1 212.715.1199
Lauren.Bittman@aporter.com