Supreme Court Finds that Foreign Transactions of Non-U.S. Securities Outside the Reach of U.S. Securities Fraud Claims

For years, foreign entities have been at risk for being sued for securities fraud under the Securities and Exchange Act of 1934 (the "1934 Act") in connection with securities transactions that occurred outside of the United States. With its June 24, 2010, decision in *Morrison v. National Australia Bank Ltd.*, however, the United States Supreme Court has brought a permanent end to that risk. The Court overruled the subjective standard that the federal courts have used to determine on a case-by-case basis whether such a claim can be prosecuted in the U.S. courts.

The Supreme Court adopted a clear and unambiguous standard. Going forward, claims under Section 10(b) of the 1934 Act may be asserted "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." Thus, a plaintiff cannot assert a claim for a foreign transaction in a non-U.S. security.

Prior to the decision, the federal courts permitted parties to commence claims under Section 10(b) of the 1934 Act with respect to foreign transactions when the claim was premised "upon either some effect upon American securities markets or investors or significant conduct in the United States." The Supreme Court criticized that standard as imprecise and not susceptible to easy application. As the Court noted, this standard resulted in unpredictable and inconsistent application of Section 10(b) to transnational cases. The Supreme Court concluded that this standard has no support in the text of the 1934 Act, and that it was contrary to the presumption against applying U.S. statutes extraterritorially.

The Supreme Court analyzed the 1934 Act, and concluded that the focus of the statute is on the purchase and sale of securities in the United States, and not on the place where the deception originated. The Court observed that Section 10(b) "does not punish deceptive conduct, but only deceptive conduct 'in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered.'" The Court further observed that, "[w]ith regard to securities *not* registered on domestic exchanges, the exclusive focus on *domestic* purchases and sales is strongly confirmed by § 30(a)(b) ...." (Original emphasis.) In that regard, the Court observed that the focus on domestic transactions also "is evident in the Securities Act of 1933, enacted by the same Congress as the [1934] Act, and forming part of the same comprehensive regulation of securities trading."

The Supreme Court rejected the assertion that the 1934 Act "reaches conduct in the [United States] affecting exchanges or transactions abroad ...." The Court took account of the probable incompatibility with the applicable laws of other countries. It observed that foreign countries likewise regulate their securities exchanges and securities transactions, and that the regulations in other countries often differ from the regulations in the United States, echoing the concerns expressed in the many *amicus* briefs filed by foreign governments and international organizations. The Court concluded that its transactional test that a purchase or sale occur in the United States or involve a security listed on a U.S. exchange avoids creating a conflict with the laws of other countries.

The Supreme Court's ruling provides clarity for the first time regarding the jurisdictional reach of Section 10(b) and fraud claims under the 1934 Act. As a result, foreign transactions of non-U.S. securities cannot be the subject of claims of securities fraud under the 1934 Act. The risk, however, still remains that conduct outside of the United States could give rise to lawsuits in the U.S. courts under the 1934 Act, if the conduct has a connection to the purchase or sale of securities in the United States or securities traded on a U.S. exchange. Companies that issue American Depositary Receipts ("ADRs") that are traded on U.S. exchanges still face the risk of liability in the event that their conduct (wherever it occurs) affects the trading of those ADRs. Likewise, foreign participants in transactions that occur in the United States, regardless of the security, face the risk of liability. Consequently, those parties who have U.S.-listed ADRs or who execute trades in the United States still need to take into account the obligations imposed by the 1934 Act in order to minimize the risk of U.S.-based litigation.

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