United States Supreme Court to Hear Case Concerning the Extraterritorial Application of U.S. Securities Laws—*Morrison v. National Australia Bank*

In recent years, securities fraud lawsuits in the United States have increasingly been brought against non-U.S. companies. In October 2008, the United States Court of Appeals for the Second Circuit issued an important decision concerning the extraterritorial application of the U.S. securities laws, *Morrison v. National Australia Bank*, 547 F.3d 167 (2d Cir. 2008). On November 30, 2009, the U.S. Supreme Court decided to hear an appeal from the Second Circuit's decision. Non-U.S. issuers with businesses in the U.S. should follow the *Morrison* case closely, along with legislation that is currently making its way through Congress concerning the extraterritorial application of the U.S. securities laws. These developments may determine the circumstances under which non-U.S. companies can be exposed to private securities fraud suits or regulatory enforcement actions in the U.S.

Background on the *Morrison* Case and the Extraterritorial Application of the U.S. Securities Laws

The Securities Exchange Act of 1934 does not state whether and to what extent its antifraud provisions apply to extraterritorial conduct involving non-U.S. defendants. The Second Circuit, which sits in New York City and is a particularly influential court in securities law matters, has traditionally used two tests to determine whether U.S. securities laws apply extraterritorially. First, the "conduct test" looks at the extent to which the allegedly fraudulent conduct occurred in the U.S. Second, the "effects test" asks whether the alleged conduct affected U.S. investors and markets.

Even before the Supreme Court decided to hear the case, *Morrison* was significant as a benchmark "foreign-cubed" case—that is, a case involving a foreign plaintiff, suing a foreign issuer, for losses arising out of purchases of stock outside the U.S.

The defendant National Australia Bank, Ltd. ("NAB") is an Australian bank whose American Depositary Receipts trade on the New York Stock Exchange. Its American mortgage service provider subsidiary, HomeSide Lending, Inc. ("HomeSide"), allegedly used fraudulent accounting in the U.S. to overstate the value of its mortgage servicing rights. HomeSide then allegedly sent those inflated figures to NAB in Australia, which disseminated them in public filings. NAB later announced two write-downs totaling $2.2 billion due to recalculations in the value of HomeSide's mortgage servicing rights. Non-U.S. investors who bought NAB stock on non-U.S. exchanges then sued NAB under antifraud provisions of the U.S. securities laws. NAB and a number of interested third parties argued for a bright-line rule that U.S. jurisdiction is always inappropriate in "foreign-cubed" cases.

The Second Circuit declined to reach such a categorical conclusion, but did hold that jurisdiction was lacking in *Morrison*. It emphasized that "NAB, not HomeSide, is the publicly traded company and its executives—assisted by lawyers, accountants, and bankers—take primary responsibility for the corporation's public filings, for its relations with investors, and for its statements to the outside world." Applying the "conduct" test, the Court held that there was no U.S. jurisdiction because the actions by NAB in Australia were significantly more central to the fraud and more directly responsible for harm to investors than the manipulation of the numbers by HomeSide in the U.S. The Court was also influenced by the "striking absence" of any allegation that the alleged fraud affected American investors or America's capital markets.

The Court declined to adopt a more lenient standard advocated by the Securities and Exchange Commission ("SEC"), which would have allowed the antifraud provisions to apply "to transnational frauds that result exclusively or principally in overseas losses if the conduct in the United States is material to the fraud's success and forms a substantial component of the fraudulent scheme." The SEC argued before the Second Circuit that, under this standard, jurisdiction was proper in *Morrison* based on HomeSide's conduct in the U.S.

The Supreme Court Grants Certiorari in *Morrison*

On November 30, 2009, the Supreme Court granted a petition for a writ of certiorari to hear *Morrison* on appeal from the Second Circuit. In their petition, plaintiffs argued that there is an entrenched split among the various courts of appeals as to the proper standard for the extraterritorial application of the U.S. securities laws.[1]

Notably, the Court decided to hear the case notwithstanding the views of the Obama Administration. At the invitation of the Court, the Solicitor General filed an *amicus* brief setting forth its position on the case. In its brief, the Solicitor General asked the Court not to hear the case and argued that plaintiffs' claims were properly dismissed by the Second Circuit. The SEC joined the Solicitor General's brief, despite having argued before the Second Circuit on the side of the plaintiffs that jurisdiction existed.

The Government's brief took the position that whether or not the fraudulent scheme was conceived and executed in whole or in part outside the U.S. is irrelevant to U.S. courts' subject matter jurisdiction. Instead, the Government argued that the location of the scheme is relevant to two non-jurisdictional issues bearing on plaintiffs' entitlement to relief: (i) whether the scheme violates Section 10(b), the relevant antifraud provision; and (ii) whether a private right of action is available under Section 10(b). The Government found the first issue satisfied, and argued that the fraudulent conduct of HomeSide and its officers in the U.S. was sufficient to allow the SEC to bring a regulatory enforcement action under Section 10(b). However, the Government went on to argue that the plaintiffs were properly denied relief because the link between HomeSide's alleged false statements and the ultimate harm to the plaintiffs was too indirect to support liability in a private suit. Lastly, the Government argued that *Morrison* would have been decided the same regardless of which Circuit Court of Appeals it was brought in, and that the case would not be a suitable vehicle for resolving any divisions among the circuits as to the appropriate standard for the extraterritorial application of the U.S. securities laws.

The Supreme Court is likely to hear argument in *Morrison* in March or April of next year, and will likely issue its opinion by the end of June. The Court could take a number of different approaches in deciding the case. The Court may establish a uniform standard for the exercise of U.S. jurisdiction over securities fraud suits involving non-U.S. parties and non-U.S. conduct, but the Court may also decide the case more narrowly. Consistent with the Government's brief, the Court may also conclude that the degree of foreign versus domestic conduct is not a jurisdictional issue at all, but instead goes to the ultimate merits of whether a private plaintiff may assert a claim and whether the SEC may bring an enforcement action.

The Investor Protection Act of 2009 and Its Implications for *Morrison*

It is also possible that legislation currently pending in Congress could supersede Morrison in determining the vulnerability of non-U.S. issuers to securities fraud suits and regulatory enforcement actions in the U.S.

---

[1] The plaintiffs described a three-way circuit split in the application of the "conduct test." First, they argued that the District of Columbia Circuit has adopted the most restrictive approach requiring that the domestic conduct at issue must *itself* constitute a securities violation. Second, the plaintiffs stated that the Third, Eighth, and Ninth Circuits follow the least restrictive approach, requiring only that at least *some* activity designed to further a fraudulent scheme occur in the U.S. Third, plaintiffs argued that the Second, Fifth, and Seventh Circuits have adopted a middle ground requiring that the domestic conduct in question be more than merely preparatory to the fraud and that it be a direct cause of the loss in question.

On October 15, 2009, the Investor Protection Act of 2009 was introduced in the House of Representatives by Representative Paul E. Kanjorski and was referred to the House Committee on Financial Services, which passed the measure on November 4. Section 215 of the legislation as currently drafted amends the Securities Act of 1933, the Securities Exchange Act of 1934 and the Investment Advisors Act of 1940 to expand jurisdiction—both in SEC enforcement actions and private civil litigation—over foreign-related transactions.[2]

The Act goes at least as far as the most expansive "conduct test" applied by the courts, and arguably further, by providing for U.S. jurisdiction whenever there is either (i) "conduct within the United States that constitutes significant steps in furtherance of [a] violation, even if the securities transaction occurs outside the United States and involves only foreign investors" or (ii) "conduct occurring outside the United States that has a foreseeable substantial effect within the United States." It is not possible at this time to determine whether this provision will become law either as drafted or in a modified form.

We will continue to keep you apprised of relevant developments concerning the *Morrison* case and the Investor Protection Act.

---

[2] The Act provides only for the extraterritorial application of the antifraud provisions in these statutes, even though similar extraterritorial issues arise under securities regulatory provisions.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact

Joel M. Cohen	212 450 4592	joel.cohen@davispolk.com
Edmund Polubinski III	212 450 4695	edmund.polubinski@davispolk.com
Lawrence Portnoy	212 450 4874	lawrence.portnoy@davispolk.com
Brian S. Weinstein	212 450 4972	brian.weinstein@davispolk.com
James H.R. Windels	212-450-4978	james.windels@davispolk.com
Robert F. Wise, Jr.	212 450 4512	robert.wise@davispolk.com