Supreme Court's *Morrison* Decision Puts an End to Litigating Foreign-Cubed Cases in U.S. Courts

On June 24, 2010, the Supreme Court issued its decision in *Morrison v. National Australia Bank*, which clarified the extraterritorial reach of U.S. securities laws. At issue in *Morrison* was the application of the principal antifraud provisions of the federal securities laws—Section 10(b) of the Securities and Exchange Act of 1934 and associated Rule 10b-5—to lawsuits brought (1) by foreign investors, (2) against foreign issuers of securities (companies incorporated in a foreign country), and (3) based on transactions on foreign securities exchanges—a so-called "foreign-cubed" transaction. Before the Supreme Court's decision in *Morrison*, U.S. courts exercised jurisdiction over foreign-cubed cases where the court determined that there was "sufficient United States involvement" in the wrongful conduct or its effects, but it was uncertain what combination of circumstances would be deemed adequate to apply U.S. law. The Supreme Court's decision puts an end to foreign-cubed cases by construing Section 10(b) not to apply extraterritorially. The Court held that Section 10(b) and Rule 10b-5 do not apply to purchases of securities that are not listed on a U.S. exchange and are not purchased in the United States.

National Australia Bank (NAB), one of Australia's largest banks, is headquartered in Melbourne, Australia. NAB's approximately 1.5 billion "ordinary shares" (the equivalent of American common stock) trade on the Australian Securities Exchange, the London Stock Exchange and the Tokyo Stock Exchange. In February 1998, NAB acquired HomeSide Lending, a mortgage service provider in Florida. In 2001, NAB disclosed that HomeSide's accounting practices had led to an overstatement of the value of its mortgage servicing rights (MSRs). NAB subsequently took two write-downs of these MSRs, totaling $2.1 billion. Following the announcements, the value of NAB's ordinary shares dropped by 5% and 13%, respectively.

Investors who purchased ordinary shares of NAB on foreign exchanges sued NAB in the Southern District of New York, claiming violations of the antifraud provisions of U.S. securities laws. The plaintiffs argued that the conduct of HomeSide and its employees in Florida in manipulating the value of HomeSide's MSRs provided a sufficient nexus to the United States for application of U.S. securities laws. The District Court dismissed the foreign investors' class action for lack of subject matter jurisdiction. The Second Circuit affirmed. Applying a test that considered whether there was significant "conduct" in the United States or its "effect" was felt here, the Second Circuit held that NAB's public statements, which were compiled in and disseminated from Australia, were "significantly more central to the fraud and more directly responsible for the harm to investors than the manipulation of the numbers in Florida." The Second Circuit left open the possibility, however, that it could exercise jurisdiction over foreign-cubed cases where the conduct in the United States or the effects on U.S. markets or investors was more significant.

The Supreme Court affirmed the Second Circuit's result, but rejected the "conduct and effects" test as permitting a projection of U.S. law beyond the country's borders that Congress had not condoned. The Court held that Section 10(b) applies only to "the purchase or sale of a security listed on an American stock exchange" or "the purchase or sale of any other security in the United States."

By eliminating the amorphous "conduct and effects" test, the Supreme Court's decision provides much needed clarity to the scope of the antifraud provisions of U.S. securities laws. The decision will be welcome news to foreign companies that engage in activities in the United States. Under the Supreme Court's decision, companies that are not listed on an American stock exchange and do not sell securities in the United States will be able to purchase a subsidiary in the United States, as NAB did, without concern that doing so will subject them to U.S. antifraud laws.

Although *Morrison* puts an end to litigating foreign-cubed cases in U.S. courts, the respite for foreign issuers may be short-lived. A provision in the financial reform bill that passed the House of Representatives would, if enacted into law, supersede the Supreme Court's ruling. Section 7216 of the Wall Street Reform and Consumer Protection Act passed by the House would amend the securities laws to provide jurisdiction over: (1) conduct within the United States constituting "significant steps in furtherance of the violation," even if the securities transaction occurs outside the United States and involves only foreign investors; or (2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States. Although the language of the House bill's "conduct" and "effects" test differs from the Second Circuit's formulation, it would reintroduce much of the uncertainty that the Supreme Court's decision eliminated. The House bill has been merged in conference with Senate legislation that had no similar provision, but the text of the final bill is not yet available.

Ropes & Gray is continuing to monitor closely this legislation and its potential effect on *Morrison*. If you have any questions regarding the impact of the *Morrison* decision or the pending financial reform legislation, please do not hesitate to contact your regular Ropes & Gray attorney.

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