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United States Supreme Court Categorically Rejects "Foreign Cubed" Class Actions, and Holds That Rule 10b-5 Does Not Apply to Foreign Transactions © [¶15.1]

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In a historic decision of immense consequence to foreign securities issuers, the Supreme Court of the United States this morning swept away four decades of lower-court case law and categorically rejected a highly vexatious species of class-action litigation that has plagued such issuers in recent years—"foreign-cubed" or "f-cubed" securities lawsuits, which involve claims of *foreign* investors against *foreign* issuers to recover losses from purchases on *foreign* securities exchanges. Addressing the territorial scope of the federal securities laws for the first time, the Court in *Morrison* v. *National Australia Bank Ltd.*, No. 08-1191 (U.S. June 24, 2010), held that Section 10(b) of the Securities Exchange Act and SEC Rule 10b-5 do not apply to transactions on foreign exchanges. The "focus" of the statute, the Court ruled, is "upon purchases and sales of securities in the United States"; as a result, the statute "reaches . . . only . . . 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." Our Firm successfully briefed and argued the case for National Australia Bank and the other defendants in the Supreme Court.

The fundamental legal question in *National Australia Bank* was one of statutory construction—how to interpret a provision that is entirely silent about whether it

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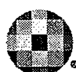
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applies extraterritorially. The practical problem of foreign-cubed litigation arose from the fact that lower courts in a more freewheeling judicial era—the 1960s and 1970s—took this statutory silence as license to make what they candidly admitted was a "policy decision" in favor of extraterritoriality. Led by the federal court of appeals in New York, these courts developed an expansive and amorphous "conduct test" for extraterritorial application of Section 10(b), a standard that applied U.S. law if more than "merely preparatory" domestic conduct led to foreign losses from foreign securities fraud. The test lacked any statutory basis: As one judge who helped create it candidly acknowledged, "if we were asked to point to language in the statutes . . . that compelled these conclusions, we would be unable to respond." But the courts applied U.S. law to foreign transactions anyway, on the theory that protecting foreign investors in this way would foster good relations with foreign nations and would thus encourage those nations to extend reciprocal protections to U.S. investors.

Things did not turn out that way. Lacking statutory guidance, the lower courts found themselves unable to develop a workable standard of extraterritoriality. As we described in our October 27, 2008 memo on the *National Australia Bank* case, the conduct test completely confused district courts, and became, as one judge accurately put it, not a "cohesive doctrine" but a set of "potentially incompatible statements of applicable rules." This jurisprudential jumble inevitably triggered a global gold rush for American class-action lawyers, who by the turn of this century began jetting around the world to recruit foreign investors to serve as plaintiffs in U.S. class actions against foreign companies. "If you want to enter new markets," one plaintiffs' lawyer told the *Wall Street Journal*, "you have to go outside the United States." And so they did.

Securities class actions thus became a fast-growing American export, as confusion over the conduct test allowed the plaintiffs' bar to coerce billion-dollar settlements from some foreign issuers and to tie down many others in expensive motion practice and discovery. By 2007, around 15% of securities class actions in American courts were being filed against foreign companies. The trend continued in the last two years, as plaintiffs' lawyers targeted foreign financial institutions (including Credit Suisse, UBS, RBS, CIBC, Société Générale, and Fortis) that suffered losses on U.S. mortgage-related investments, and culminated in a January 2010 jury verdict against the French conglomerate Vivendi that plaintiffs' lawyers said would ultimately be worth over $9 billion. Far from fostering friendly international relations, these developments ultimately led the governments of Australia, Britain, and France, in *amicus curiae* briefs they filed in the Supreme Court in *National Australia Bank*, and Switzerland, in a diplomatic note to the Department of State, to vigorously protest foreign-cubed suits as violations of international law.

Today the Supreme Court, once and for all, put an end to the abuse. Justice Scalia's opinion for the Court explained that "the unpredictable and inconsistent application" of the lower courts' extraterritoriality standards, and the confusing "proliferation of vaguely related variations" of those standards, stemmed from disregard of the "presumption against extraterritoriality"—a traditional canon of statutory construction teaching that "when a statute gives no clear indication of an extraterritorial application, it has none." The Court observed that "the results of judicial-speculation-made-law—divining what Congress would have wanted if it had

thought of the situation before the court—demonstrate the wisdom of the presumption against extraterritoriality."

Applying the presumption, the Court ruled that Section 10(b) "contains nothing to suggest it applies abroad," and thus does *not* apply abroad. The Court noted that "the focus of the Exchange Act is not upon the place where the [alleged] deception originated, but upon purchases and sales of securities in the United States." As a result, "it is . . . only transactions in securities listed on domestic exchanges, and domestic transactions in other securities, to which § 10(b) applies." Put another way, "it is the foreign location of the *transaction* that establishes . . . the Act's inapplicability." The Court noted that "adoption of [this] clear test" would assuage the concerns expressed by the foreign government *amici* about the infringement of their sovereign powers by Section 10(b). Finally, in colorful language, the Court rejected the U.S. government's suggestion that the Court retain the conduct test in order to "prevent[] the United States from becoming a 'Barbary Coast' for malefactors perpetrating frauds in foreign markets." The Court's response: If "one is to be attracted" by this consideration, "one should also be repulsed by [the] adverse consequences" of the conduct test—namely, that it has arguably caused the United States to "become the Shangri-La of class-action litigation for lawyers representing those allegedly cheated in foreign securities markets."

The days of this foreign-cubed Shangri-La are now over. Today's decision represents a tremendous victory for foreign companies, which no longer will face the threat of global securities litigation under U.S. laws and rules. It also represents a victory for the American economy, because foreign companies no longer need be deterred by foreign-cubed litigation from expanding their U.S.-based activities. Equally important, today's decision has significant implications for foreign firms under other federal statutes as well. For example, the lower courts have construed RICO, the Racketeer Influenced and Corrupt Organizations Act, as incorporating extraterritoriality standards mirroring those applied under the securities laws. Indeed, the Supreme Court soon will decide, probably on Monday, whether to review *British American Tobacco* v. *United States*, No. 09-980, a case squarely presenting the question whether and to what extent RICO applies extraterritorially. Whether or not it decides to hear that case, however, the message the Supreme Court of the United States today has sent lower courts and the world is clear: Regardless of the subject matter, American laws do not apply abroad unless Congress affirmatively so provides.

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