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The *National Australia* Juggernaut Rolls On: Federal District Court Dismisses Securities Claims Based Upon Swaps Referencing Foreign Securities

In a important decision handed down late last week, the United States District Court for the Southern District of New York held that the federal securities laws do not permit recovery of losses from swap agreements that reference securities traded on foreign exchanges. *Elliott Associates, L.P.* v. *Porsche Automobil Holding SE*, No. 10 Civ. 532 (HB) (S.D.N.Y. Dec. 30, 2010). This decision in the closely-watched *Porsche* litigation provides yet another illustration of the dramatic impact of the Supreme Court's landmark decision last June in *Morrison* v. *National Australia Bank*, which (as discussed in our previous memos here, here, and here) held that antifraud provisions of the federal securities laws do not apply to transactions that take place abroad.

Porsche arose from a notorious short squeeze in Volkswagen shares that occurred in October 2008, after Porsche announced that it had acquired the economic equivalent of a 74% stake in VW. The squeeze was massive one, and for a few hours gave VW the highest market capitalization in the world. The plaintiffs were hedge funds—American and foreign—that lost billions of dollars covering their VW short positions. They alleged that Porsche had engineered the short squeeze by lying about its intentions toward, and about its holdings in, VW.

VW shares trade only outside the United States, and the hedge funds conceded that *National Australia* barred them from recovering losses on positions they *directly* held in those shares. They nonetheless argued that they could recover losses they sustained on *swap agreements* that referenced the price of VW shares and that were economically similar to short sales. Those swap transactions, the hedge funds argued, were carried out in the United States, and accordingly fell within the territorial scope of federal law under *National Australia*.

Last week's decision roundly rejected this contention. Accepting the hedge funds' "narrow reading" of *National Australia*, Judge Harold Baer explained, "would extend extraterritorial application of the Exchange Act's antifraud provisions to virtually any situation in which one party to a swap agreement is located in the United States," and would thus be "inconsistent with the Supreme Court's intention in that case to curtail the extraterritorial application of § 10(b)." For the "swaps were the functional equivalent of trading the underlying VW shares on a German exchange." As a result, the court reasoned, "the economic reality" was that the "swap agreements are essentially transactions conducted upon foreign exchanges and markets, and not domestic transactions that merit the protection" of American law under *National Australia*.

The district judge concluded: "In light of [*National Australia*'s] strong pronouncement that U.S. courts ought not interfere with foreign securities regulation without a clear Congressional mandate, I am loathe to create a rule that would make foreign issuers with little relationship to the U.S. subject to suits here simply because a private party in this country entered into a derivatives contract that references the foreign issuer's stock. Such a holding would turn [*National Australia*'s] presumption against extraterritoriality on its head."

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