

THE SECOND CIRCUIT CLARIFIES THE TERRITORIAL LIMITATIONS OF SECURITIES FRAUD CLAIMS UNDER MORRISON V. NATIONAL AUSTRALIA BANK

In *Morrison v. National Australia Bank, Ltd.* the United States Supreme Court held that Section 10(b) of the Securities and Exchange Act of 1934 (the “Exchange Act”) applied only to (1) “transactions in securities listed on domestic exchanges” and (2) “domestic transactions in other securities”.¹ In the wake of the Supreme Court’s ruling in *Morrison*, courts have struggled to define the outer limits of the Exchange Act’s territorial reach. On May 6, 2014, the Court of Appeals for the Second Circuit, in *City of Pontiac Policeman’s and Fireman’s Retirement Sys. v. UBS AG* (“*City of Pontiac*”), clarified the scope of the “domestic transaction” standard under *Morrison*.² The Second Circuit held that purchasers of foreign securities on foreign exchanges cannot allege a domestic transaction merely because those securities were cross-listed on a domestic exchange.³ The Second Circuit further held that the mere placement of a buy order in the United States to purchase securities on a foreign exchange is insufficient to allege a domestic transaction.⁴

BACKGROUND ON THE CITY OF PONTIAC CASE

The plaintiffs in *City of Pontiac* were a group of foreign and domestic institutional investors who purchased ordinary shares of UBS AG, which were listed on the Swiss Stock Exchange, the Tokyo Stock Exchange and the New York Stock Exchange (“NYSE”).⁵ The plaintiffs alleged that UBS AG and a number of its officers and directors violated the Exchange Act by making supposedly fraudulent statements concerning UBS’s portfolio of mortgage-related assets and its compliance with United States tax and securities laws.⁶ On September 13, 2011, Judge Richard Sullivan in the United States District Court for the Southern District of New York dismissed the claims of the foreign and domestic plaintiffs who purchased UBS shares on foreign exchanges for failure to plead domestic transactions under *Morrison*.⁷

THE SECOND CIRCUIT CLARIFIES THAT TRANSACTIONS ON FOREIGN EXCHANGES ARE NOT DOMESTIC

The Second Circuit affirmed the district court’s dismissal under *Morrison* and rejected the plaintiffs’ two main arguments for reversal.⁸ First, relying on the express language in

¹ *Morrison v. National Australia Bank, Ltd.*, 130 S. Ct. 2869, 2884 (2010).

² *City of Pontiac Policeman’s and Fireman’s Retirement Sys. v. UBS AG* (“*City of Pontiac*”), No. 12-4355-cv, __ F.3d __, 2014 WL 1778041 (2d Cir. May 6, 2014)

³ *Id.* at *4.

⁴ *Id.*

⁵ *In re UBS Sec. Litig.*, 07 CIV. 11225 RJS, 2011 WL 4059356, at *1 (S.D.N.Y. Sept. 13, 2011).

⁶ *Id.*

⁷ *Id.*

⁸ *City of Pontiac*, 2014 WL 1778041, at *1.

Morrison that § 10(b) applies to “the purchase or sale of a security listed on an American stock exchange”,⁹ the plaintiffs argued that a securities transaction is domestic whenever the securities at issue are listed on a domestic exchange regardless of where the securities are actually purchased. Thus, the plaintiffs contended that their purchases of UBS shares on foreign exchanges were domestic transactions because UBS shares were cross-listed on the NYSE. The Second Circuit rejected the plaintiffs’ so-called “listing theory” as irreconcilable with *Morrison* when read as a whole.¹⁰ According to the Second Circuit, the domestic transaction test under *Morrison* is concerned with the location of the securities transaction and not the location of an exchange where the security may be dually listed.¹¹ Thus, as a matter of first impression, the Second Circuit held that “*Morrison* does not support the application of § 10(b) of the Exchange Act to claims by a foreign purchaser of foreign-issued shares on a foreign exchange simply because those shares are also listed on a domestic exchange.”¹²

Second, a United States plaintiff argued on appeal that its purchases of UBS shares on a foreign exchange were “domestic transactions in other securities” under the second prong of *Morrison* because it placed its buy orders in the United States. The Second Circuit disagreed.

The Second Circuit applied the test set forth in its prior decision in *Absolute Activist Value Master Fund Ltd. v. Ficeto* (“*Absolute Activist*”) which holds that a transaction is domestic under the second prong of *Morrison* only if “the parties incurred irrevocable liability to carry out the transaction within the United States or when title passed within the United States.”¹³ The Second Circuit rejected the plaintiff’s argument that irrevocable liability was incurred in the United States where the buy order was placed and not when the order was executed on the foreign exchange.¹⁴ According to the panel, a party’s citizenship or residency is irrelevant under the irrevocable liability test.¹⁵ Moreover, the allegation that a plaintiff used a United States broker does not, standing alone, establish that irrevocable liability was incurred in the United States.¹⁶ Thus, the Second Circuit held as a matter of first impression that “the mere placement of a buy order in the United States for the purchase of foreign securities on a foreign exchange” is insufficient to allege that “a purchaser incurred irrevocable liability in the United States, such that the U.S. securities laws govern the purchase of those securities.”¹⁷

⁹ *Morrison*, 130 S. Ct. at 2888.

¹⁰ *City of Pontiac*, 2014 WL 1778041, at *3.

¹¹ *Id.*

¹² *Id.* at *4.

¹³ See *id.* (quoting *Absolute Activist Value Master Fund Ltd. v. Ficeto*, 677 F.3d 60, 69 (2d Cir. 2012)).

¹⁴ *City of Pontiac*, 2014 WL 1778041, at *4.

¹⁵ *Id.*

¹⁶ See *id.* at *4, n.33.

¹⁷ *Id.* at *4.

**IMPACT OF THE DECISION**

The Second Circuit's decision in *City of Pontiac* clarifies the territorial limits of the Exchange Act as defined by *Morrison*. By rejecting the plaintiffs' listing theory, the Second Circuit in *City of Pontiac* provided certainty to foreign issuers that cross-listing their shares on a United States exchange would not expose them to liability under United States securities laws for transactions on foreign exchanges. Moreover, *City of Pontiac* provides significant guidance concerning the standard for pleading a domestic transaction under *Morrison* and *Absolute Activist*. The mere placement of a buy order in the United States, by itself, is insufficient. Under *City of Pontiac*, a purchaser does not incur irrevocable liability upon placing a buy order where the broker executes the order on a foreign exchange.

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