

U.S. SUPREME COURT LIMITS EXTRATERRITORIAL APPLICATION OF FEDERAL SECURITIES LAWS

By James G. Smith



The United States Supreme Court unanimously held that the antifraud provisions of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, apply only to transactions in securities that take place in the United States or transactions in securities listed on a U.S. securities exchange. The Court's opinion in *Morrison v. National Australia Bank Ltd.*, 561 U.S. ___, No. 08-1191 (June 24, 2010) went beyond just the extraterritorial application of the antifraud provisions of Section 10(b) to federal securities laws in general. The decision will have significant impact on the application of U.S. securities laws to foreign securities transactions.

In *Morrison*, the Court considered the Second Circuit's view that the courts discern, in the absence of express intent, whether Congress intended a statute to apply outside the United States. The Court rejected the Second Circuit's view. Justice Scalia, writing the Court's opinion, set forth the bright line test: "When a statute gives no clear indication of an extraterritorial application, it has none."

Justice Scalia highlighted that nothing in Section 10(b) suggests that section applies outside the United States. In his analysis, Justice Scalia ventured outside of Section 10(b) to other provisions of the Exchange Act. Citing Section 30(b) of the Exchange Act, Justice Scalia noted that in that section Congress did address extraterritorial application, but such application would only arise by virtue of Securities and Exchange Commission rule or regulation. Section 30(b) provides:

The provisions of [the Exchange Act] or of any rule or regulation thereunder shall not apply to any person insofar as he transacts a business in securities without the jurisdiction of the United States, unless he transacts such business in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate to prevent the evasion of [the Exchange Act].

Justice Scalia also cited Exchange Act Section 30(a) for the

proposition that foreign application of federal securities laws only arises when Congress is explicit. Section 30(a) provides:

It shall be unlawful for any broker or dealer, directly or indirectly, to make use of the mails or of any means or instrumentality of interstate commerce for the purpose of effecting on an exchange not within or subject to the jurisdiction of the United States, any transaction in any security the issuer of which is a resident of, or is organized under the laws of, or has its principal place of business in, a place within or subject to the jurisdiction of the United States, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors or to prevent the evasion of [the Exchange Act].

The Court's decision leaves open the expansion of the application, or the absence of application, of federal securities laws to other securities transactions that occur outside the United States. One such application includes broker-dealer registration under Section 15 of the Exchange Act for United States bankers involved in securities transactions of non-United States issuers and non-United States investors. Justice Scalia noted:

With regard to securities not registered on domestic exchanges, the exclusive focus on domestic purchases and sales is strongly confirmed by §30(a) and (b), discussed earlier. The former extends the normal scope of the Exchange Act's prohibitions to acts effecting, in violation of rules prescribed by the Commission, a "transaction" in a United States security "on an exchange not within or subject to the jurisdiction of the United States." And the latter specifies that the Act does not apply to "any person insofar as he transacts a business in securities without the jurisdiction of the United States," unless he does so in violation of regulations promulgated by the Commission "to prevent evasion [of the Act]." Under both provisions it is the foreign location of the transaction that establishes (or reflects the presumption of) the Act's inapplicability, absent regulations by the Commission.

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The Court did not address the issue of defining what constitutes a domestic securities transaction. That will need to be addressed by the lower courts.

The Investor Protection and Securities Reform Act of 2010, part of the sweeping Dodd-Frank Wall Street Reform and Consumer Protection Act, seems to attempt to address the Court's decision as it applies to the antifraud provisions of the Exchange Act, the Securities Act and the Investment Advisors Act. For example, the bill proposes to amend the Exchange Act to add the following:

The district courts of the United States and the United States courts of any Territory shall have jurisdiction of an action or proceeding brought or instituted by the Commission or the United States alleging a violation of the antifraud provisions of this title involving (1) conduct within the United States that constitutes 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.

Rep. Paul Kanjorski was reported to have stated on the House floor that such provisions in Dodd-Frank were intended to indicate that Congress clearly intends extraterritorial application in fraud cases brought by the government. If that is Congress' intent, then Rep. Kanjorski misread the Court's decision. The Supreme Court explicitly held that the U.S. District Court had subject matter jurisdiction over the case. Dodd-Frank revisits subject matter jurisdiction which the Court already held exists. But Dodd-Frank fails to address the substance of the Court's decision – the absence of extraterritorial application of the federal securities laws' antifraud provisions.

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