

By Vincent Caracciolo and Tara Cummins

The Supreme Court Weighs In

In our recent white paper, “Morrison v. NAB: Will U.S. Courts Be a Safe Haven for Fraud?,” we discussed the case of Morrison v. National Australia Bank (“*Morrison*”), litigation with the potential to fundamentally alter the landscape of securities litigation globally. At stake in the case is the reach of certain U.S. Securities anti-fraud laws and whether foreign entities issuing foreign securities abroad need fear long-arm jurisdiction of U.S. Courts.

On June 24, 2010, the Supreme Court issued its opinion in *Morrison*, holding against the extraterritorial application of Section 10(b) of the Securities and Exchange Act of 1934. (*Morrison et al. v. National Australia Bank Ltd. et al.*, 561 U.S. ____ (2010) (No. 08-1191).

The Viability of F-Cubed Jurisdiction

Morrison centers on foreign shareholders who purchased shares of an Australian bank on foreign exchanges. Plaintiffs suffered loss when the bank restated its financials upon discovery that an acquired U.S. subsidiary had been allegedly inflating the value of its mortgage servicing fees.

The bank moved to dismiss the claims of foreign plaintiffs, arguing that the court did not have subject-matter jurisdiction over so-called “F-Cubed” scenarios—claims of foreign plaintiffs who purchase foreign shares on foreign exchanges, and that granting it would threaten comity sovereign authority of other nations. Plaintiffs argued that failing to recognize the extraterritoriality of the anti-fraud provisions of U.S. Securities Laws would open up the U.S. markets as a playground for fraud.

Failure to State a Claim

The Supreme Court begins its analysis of the case with a clarification and correction, holding that the Second Circuit’s consideration of the extraterritorial reach of Section 10(b) was incorrect, and that procedurally the issue to be addressed is whether or not the plaintiffs have failed to state a claim under Rule 12(b)(6). Opining that the same analysis would apply in both situations, the court held it unnecessary to remand and continued to determine whether or not the Securities Exchange Act extends a cause of action for foreign plaintiffs suing for misconduct related to foreign securities traded on foreign exchanges.

The Presumption Against Extraterritoriality

The Court holds against the extraterritorial application of 10(b), reasoning that “When a statute gives no clear indication of an extraterritorial application, it has none.”¹ In other words, U.S. laws begin with a presumption against extraterritoriality

¹ *Morrison et al. v. National Australia Bank Ltd et al.*, 561 U.S. ____ , 6 (2010). No. 08-1191.

unless the legislation specifies otherwise. Indeed, the court rebukes Federal appellate courts for a habit of judicial activism in using “conducts and effects” tests to infer Congressional intent on a case-by-case basis. The court iterates that the interests of stability require a more consistent approach: “Rather than guess anew in each case, we apply the presumption in all cases, preserving a stable background against which congress can legislate with predictable effects.”²

Notwithstanding the presumption against extraterritoriality, plaintiffs argue that because the alleged fraud took place in an acquired U.S. subsidiary, the statute should still apply on a domestic basis. The Court refuses, however, reasoning that “the focus on the Exchange Act is not upon the place where the deception originated but upon purchases and sales of securities in the United States.”³

Far from embracing the concept of extraterritoriality of the anti-fraud provisions of section 10(b) of the 34 Act, the Supreme Court has made clear that, as written, U.S. law does not extend the private right of action under the anti-fraud provisions beyond connection with 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. The clarification suggests that foreign plaintiffs in the U.S. will decrease, the U.S. federal court system and its resources will be somewhat less taxed from at least one source, and purely “foreign” public companies/directors/officers can rest a little easier from being successfully dragged into an in terrorem 10(b) class action.

Foreign companies with significant operations in the U.S. who were watching *Morrison* may take comfort that their careful corporate and tax-planning efforts are likely not affected for now, as the case demonstrates weakened jurisdictional exposure to U.S. courts.

D&O Market Impact

The Supreme Court decision in *Morrison* sends a positive message to foreign corporations and their officers/directors. The current anti-fraud provisions should not necessarily entangle them with the long arm of the current U.S. 10(b) anti-fraud exposure, and the clarity on exposure should take pressure off of D&O liability premiums for some.

As with many issues litigated through the highest court, while the opinion is final, the issue is not necessarily dormant. The potential for a reconsideration of extraterritoriality by the U.S. legislature remains. The court does not suggest that extraterritoriality is unconstitutional, but rather that it is not called for under the present form of the U.S. 10(b) legislation. Changing the legislation can change or negate the impact of the decision. With the passing of the Dodd-Frank financial reform legislation, the U.S. Congress has focused on systemic risks and extraterritorial considerations and the legislation indeed calls for a study on whether private right of actions should extend to extraterritorial fact patterns. Thus, while

² Morrison et al. v. National Australia Bank Ltd et al., 561 U.S. ____ , 12 (2010). No. 08-1191.

³ Ibid, at 17.

Morrison settles the issue, Dodd-Frank may muddy the waters on the topic once again in the near future.

A well-tailored D&O policy with global coverage grants, as well as consideration of where local policies should fit into corporate risk management decisions, continue to be important aspects of risk management for foreign and domestic insureds alike.

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About Integro

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