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Morrison v. Nat'l Australia Bank Ltd.: The Supreme Court Rejects Extraterritoriality

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Introduction

For more than forty years, U.S. courts have applied the antifraud provisions of federal securities law to actors and transactions operating outside the United States. In *Morrison v. Nat'l Australia Bank Ltd.*,[1] decided on June 24, 2010, the Supreme Court gave a firm and unambiguous rebuke to this practice. It is not enough, the Court stated, that international law may permit such regulation. Rather, Congress must clearly indicate that it wants U.S. law to apply to securities transactions in foreign markets. Shortly thereafter, Congress effectively confirmed this result. In the Dodd-Frank Wall Street Reform and Consumer Protection Act, enacted on June 21,[2] Congress authorized only the U.S. government and the Securities and Exchange Commission, and not private investors, to bring suit with respect to foreign transactions.

Since 1991, the Court has applied a strong presumption against extraterritoriality to force Congress, rather than the judiciary, to manage the risk that U.S.-prescribed rules might conflict with those of other sovereigns. None of its previous cases, however, have overturned such longstanding and extensive lower-court precedent. A petition for certiorari currently before the Court may give it the opportunity to decide next year whether its approach in *Morrison* applies to the Alien Tort Statute, which the lower courts have embraced as a means for addressing human rights violations.

I. The Lower Courts and Extraterritorial Federal Securities Regulation

Section 10(b) of the Securities and Exchange Act of 1934 provides that it is unlawful to use, in connection with the purchase or sale of a security, "any manipulative or deceptive device or contrivance" in contravention of rules promulgated by the Securities and Exchange Commission (SEC).[3] SEC Rule 10b-5 in turn prohibits fraud, including making untrue statements of material facts or omitting to state a material fact that is necessary to make a statement not misleading.[4] Neither the legislation nor the regulations provide expressly for a right of private persons to sue for compensation when a violation of these rules causes an injury, but since the 1960s the federal courts have assumed that this right exists.

U.S. securities legislation also does not indicate whether Section 10(b) applies outside the territory of the United States, aside from a generic reference to interstate commerce that comprises foreign commerce. But beginning in 1968, a line of Second Circuit cases determined that participants in securities transactions could sue for injury resulting from activities taking place outside the United States, if those activities either have a substantial effect on the value of securities traded in the United States, or if substantial conduct in the United States contributes to a foreign fraudulent scheme.[5] Without exception, the other circuits adopted the Second Circuit's approach, although slight variations in detail emerged. Thus, for more than forty years, U.S. courts have allowed persons injured by foreign activity to bring suits under Rule 10b-5, if they could satisfy either the effects or conduct test.

U.S. regulation of foreign transactions that have an effect on the U.S.

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economy has been controversial internationally. Beginning in 1945, U.S. courts allowed the Justice Department to sue under the antitrust laws in cases that met the effects test.[6] Australia, Canada, and many European countries, among others, objected specifically to the application of U.S. antitrust law to activity taking place on their territory, and to the effects test in general. They argued that, under international law, a sovereign's power to prescribe rules of conduct was limited to its territory or to its subjects. By the end of the 1980s, however, many countries had come to embrace the effects test as a necessary complement to national economic regulation operating in the context of a global economy. Some still worried about U.S. litigation, however, in part because other countries do not normally allow private suits to enforce public regulation, and in part because aspects of U.S. litigation such as class actions, contingency fees, jury rights, extensive pretrial discovery, and punitive damages seem friendlier to plaintiffs than the procedural rules that apply to civil litigation elsewhere in the world.

II. The *Morrison* Decision

This dispute arose out of the purchase of HomeSide, a Florida-based mortgage servicing company by National, an Australian bank. After three years of apparent prosperity, HomeSide's business collapsed, and National wrote down the value of the company on its books by more than $ 2 billion. Investors who had purchased National stock before the write-down brought suit against National, HomeSide, and top executives in both companies, claiming that they had covered up news of the losses and thus propped up the price of National stock fraudulently. The district court dismissed the suit, and the Second Circuit affirmed. The Second Circuit noted that the case involved only foreign plaintiffs, securities issued by a foreign company, and transactions in those securities that took place exclusively in a foreign country. Rather than relying directly on these three factors, however, it instead applied a balancing test and determined that the heart of the alleged conspiracy involved a cover-up that took in place in Australia. This center-of-gravity approach dictated dismissal of the suit.

The Supreme Court unanimously affirmed the result, but the majority opinion, written by Justice Scalia, strongly repudiated the lower court's reasoning. In 1991, the Court had restated a presumption against extraterritoriality, which puts the burden on Congress to clearly indicate when it wanted its rules to apply to foreign conduct.[7] That presumption, Scalia wrote, applies to the federal securities laws, notwithstanding the longstanding lower court practice to the contrary. The Court also rejected several arguments made by the Solicitor General as *amicus curiae* in favor of inferring from the language of the securities laws that Congress expected Section 10(b) to operate outside the United States. Accordingly, the Court ruled that the antifraud rules apply only to transactions involving securities that trade on U.S. exchanges or transactions where ownership of securities changes hands in the United States.

Congressional reaction to the decision was immediate and for the most part supportive. Less than twenty-four hours after the Court handed down its decision, a conference committee completed work on the Dodd-Frank Wall Street Reform and Consumer Protection Act. The bill reported out of conference authorizes the Justice Department and the SEC to bring suits alleging violations of the securities laws with respect to foreign transactions, if there exists "conduct within the United States that constitutes significant steps in furtherance of the violation, or if conduct occurring outside the United States [had] foreseeable substantial effect within the United States."[8] The bill also directs the SEC to study the possibility of extraterritorial enforcement of the securities laws through private litigation.[9] These amendments, which Congress enacted July 15, make clear that, as to private suits such as the *Morrison* litigation, the restrictions read into the securities laws by the Supreme Court remain in effect.

III. Implications

Morrison represents one more step, although an especially dramatic one, in the Supreme Court's effort to shift the responsibility for managing international regulatory conflicts from the judiciary to Congress. Rather than reading legislation as reaching the full range of transactions permitted under "prevailing notions of international comity," the Court left it to Congress to indicate how much of its extraterritorial regulatory authority it wishes to exercise.[10] Because any extraterritorial regulation has the potential to fray international relations, the *Morrison* majority insisted on applying a sweeping

Securities and Exchange Commission

U.S. Supreme Court

U.S. Court of Appeals for the Second Circuit

rule categorically barring the courts from entering into the field without clear congressional authorization. Regulatory gaps that result must await further legislative action.

Morrison also offers the latest evidence of the Court's skepticism of private litigation in aid of public regulation. The Solicitor General had argued that a refusal to extend the securities laws extraterritorially would create a risk that the United States might become a safe refuge for malefactors operating in foreign markets.[11] The Court responded that,

> [w]hile there is no reason to believe that the United States has become the Barbary Coast for those perpetrating frauds on foreign securities markets, some fear that it has become the Shangri-La of class-action litigation for lawyers representing those allegedly cheated in foreign securities markets.[12]

Earlier, in an antitrust case, the Court had indicated that a reading of the statutory standing provision so as to exclude certain foreign victims in cases where the United States still had authority to bring suit was consistent with the broader purposes of the regulatory scheme.[13] In both cases, the Court acknowledged the possibility that U.S. rules might produce too much deterrence of business behavior that might not cause any social harm, but could be confused with actionable conduct.

Conclusion

Finally, one must wonder what *Morrison* implies about other statutes. An area where the issue is likely to arise involves the so-called Alien Tort Statute,[14] the ancient law that the Supreme Court in *Sosa v. Alvarez-Machain* interpreted as providing some basis for lawsuits brought by aliens for violations of international law.[15] The Justice Department in several briefs has argued that the presumption against extraterritoriality applies to this statute.[16] Scholarly support exists for the argument that Congress adopted this statute to provide a remedy for breaches of international law for which the United States ultimately might be held responsible, which would rule out its application to actions undertaken by or on behalf of foreign states on another sovereign's territory.[17] With at least one petition for certiorari raising this question currently before the Court, it is possible that we will learn in the near future whether *Morrison* extends this far.[18]

About the Author

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Endnotes

[1] Morrison v. Australia Nat'l Bank Ltd., No. 08-1191 (U.S. June 24, 2010), *available at* http://www.supremecourt.gov/opinions/09pdf/08-1191.pdf.

[2] Dodd-Frank Wall Street Reform and Consumer Protection Act, H.R. 4173 (2010), *available at* http://financialservices.house.gov /singlepages.aspx?NewsID=3&RBID=775.

[3] 15 U.S.C. § 78j.

[4] 17 C.F.R. § 240.10b-5 (2009).

[5] *See* Schoenbaum v. Firstbrook, 405 F.2d 200 (2d Cir. 1968); Leasco Data

Processing Equip. Corp. v. Maxwell, 468 F.2d 1326 (2d Cir. 1972); Bersch v. Drexel Firestone, Inc., 519 F.2d 974 (2d Cir. 1975); IIT v. Vencap, Ltd., 519 F.2d 1001 (2d Cir. 1975). All of these opinions aside from *Schoenbaum* were written by Henry Friendly, perhaps the most widely admired court of appeals judge of his generation.

[6] United States v. Aluminum Co. of Am., 148 F.2d 416 (2d Cir. 1945).

[7] EEOC v. Arabian Am. Oil Co., 499 U.S. 244 (1991).

[8] Dodd-Frank Wall Street Reform and Consumer Protection Act, H.R. Rep. 111-517, § 929P(b). Similar language appeared in the House version of the bill, but not in the Senate version.

[9] *Id.* § 929Y. This provision appeared for the first time in the conference version.

[10] *Morrison*, No. 08-1191, slip op. at 23.

[11] Brief of the United States as Amicus Curiae, Morrison v. Australia Nat'l Bank Ltd., No. 08-1191, slip op. at 16-17.

[12] *Morrison*, No. 08-1191, slip op. at 21-22.

[13] F. Hoffman-La Roche Ltd. v. Empagran S.A., 542 U.S. 155, 169 (2004).

[14] 28 U.S.C. § 1350. This statute is the codified version of language included in Section 9 of the Judiciary Act of 1789. Courts and scholars have characterized it variously as the Alien Tort Statute and the Alien Tort Claims Act, but Congress itself never bestowed a name on this hotly contested provision.

[15] 542 U.S. 692 (2004).

[16] *See, e.g.*, Brief of the United States as Amicus Curiae in Support of Petitioners, Am. Motors Isuzu, Inc. v. Ntsebeza, No. 07-919, slip op. at 12-16.

[17] *See, e.g.,* Thomas H. Lee, *The Safe-Conduct Theory of the Alien Tort Statute*, 106 COLUM L. REV. 830 (2006) (explaining that this theory is, like most things associated with the Alien Tort Statute, controversial).

[18] Conditional Cross-Petition of Talisman Energy, Inc. for a Writ of Certiorari, Talisman Energy, Inc. v. Presbyterian Church of Sudan, No. 09-1418 (U.S. Sept. 27, 2010).