Bloomberg BNA

The United States
Law Week

Case Alert & Legal News™

Post-*Morrison* Trends in the Extraterritorial Application of Section 10(b) of the Exchange Act

By Mara Leventhal

In *Morrison v. National Australia Bank Ltd.*, 2010 BL 142333, 78 U.S.L.W. 4700, 130 S. Ct. 2869, 2877-83 (2010), the U.S. Supreme Court rejected the so-called ''conduct and effects test'' previously employed to determine the extraterritorial application of Section 10(b) of the Exchange Act. *Morrison* explained that ''the focus of the Exchange Act is not the place where the deception originated, but upon the purchases and sales of securities in the United States.'' *Id*. at 2884.

In the nearly two years since *Morrison* discarded the ''conduct and effects test,'' courts have undertaken to determine anew the contours and limits of Section 10(b)'s extraterritorial application. While the law is most decidedly still evolving, a review of the case law to date reflects that certain interpretive issues are beginning to resolve.

A. The First Prong: 'Transactions in Securities Listed on Domestic Exchanges'

1. The First Prong Requires Listed Securities to Be Traded on a Domestic Exchange. Although the first type transactions to which Section 10(b) applies under *Morrison*—''transactions in securities listed on domestic exchanges''—clearly includes securities traded on domestic stock exchanges, litigants have advanced the argument that any purchase or sale of a security listed or cross-listed on an American stock exchange may give rise to a Section 10(b) claim, even where the transaction at issue took place on a foreign exchange. This so-called ''listing theory'' has now been squarely rejected by virtually every court that has considered it.

In re Alstom SA Securities Litigation, 741 F. Supp. 2d 469, 471-73, 2010 BL 301672 (S.D.N.Y. 2010), for example, held that transactions in common shares ''registered and listed on the NYSE, though not actually purchased there,'' were not subject to Section 10(b) claims. *In re Alstom* explained that the listing theory:

> presents a selective and over-technical reading of *Morrison* that ignores the larger point of that decision. Though isolated clauses of the opinion may be read as requiring only that a security be 'listed' on a domestic exchange for its purchase anywhere in the world to be cognizable under the federal securities laws, those excerpts read in total context compel the opposite result . . . the [*Morrison*] Court was concerned with the territorial location where the purchase or sale was executed and the securities exchange laws that governed the transaction. . . . § 10(b)'s focus would not encompass purchases and sales of covered securities that occur outside of the United States.

Id. at 472-73 (citations omitted).

In re UBS Securities Litigation, No. 07 Civ. 11225 (RJS), 2011 WL 4059356, at *5 (S.D.N.Y. Sept. 13, 2011), which likewise held that ''foreign-cubed claims asserted against issuers whose securities are crosslisted on an American exchange are outside the scope of § 10(b),'' set forth a similar rationale.[2] *In re UBS* determined that the ''listing theory'' could not ''be harmonized with the *Morrison* Court's clear intention to limit the extraterritorial reach of § 10(b)'' because it would permit a Section 10(b) suit to ''be brought by *any* plaintiff who purchased stock on *any* securities exchange

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[2] Foreign-cubed actions are ''actions in which '(1) *foreign* plaintiffs [are] suing (2) a *foreign* issuer in an American court for violations of American securities laws based on securities transactions in (3) *foreign* countries.' '' *Morrison*, 130 S. Ct. at 2894 n. 11 (Breyer, J., concurring in part and concurring in the judgment) (quoting *Morrison v. National Australia Bank Ltd.*, 547 F.3d 167, 172, 77 U.S.L.W. 1269 (2d Cir. 2008) (emphasis in original).

 ISSN 0148-8139

against *any* issuer, as long as the stock at issue was cross-listed on an American exchange.'' *Id*. at *5 (emphasis in the original). Thus, the plaintiff's failure ''to allege any domestic conduct at all other than Defendants' listing of UBS stock on an American exchange'' fell short of ''a domestic connection sufficient to invoke § 10(b).'' *Id*. at *6.[3]

2. The First Prong is Satisfied by Transactions by Foreign Investors on Domestic Exchanges. But while a securities transaction on a foreign exchange cannot give rise to Section 10(b) liability, a foreign investor's securities transaction on a domestic exchange is squarely within Section 10(b)'s ambit. *See Lapiner v. Camtek Ltd.*, No. C 08-01327 MMC, 2011 BL 26723, 2011 WL 445849, at *2 (N.D. Cal. Feb. 2, 2011) (rejecting motion to dismiss Section 10(b) claim in connection with securities purchased on the NASDAQ exchange where most of the stock at issue ''was held in Israel by Israelis''); *Foley v. Transocean Ltd.*, 272 F.R.D. 126, 133-34 (S.D.N.Y. 2011) (holding that ''nothing'' in *Morrison* ''provides any support for the notion that foreign investors are not adequate plaintiffs in United States courts when the securities at issue were purchased on a United States exchange''). *Cf. Securities and Exchange Commission v. Ficeto*, No. CV 11-1637-GHK (RZx), 2011 WL 7445580, at *13 (C.D. Cal. Dec. 20, 2011) (holding Section 10(b) applicable to ''securities sold in the domestic over-the-counter market, even if the purchaser were located abroad'').

B. The Second Prong: What is a 'Domestic Transaction in Other Securities'?

Morrison expressly recognized that, even with respect to purely foreign securities transactions, some connection to the United States in most cases was likely, but nevertheless an insufficient basis to apply Section 10(b). As the Supreme Court explained, ''it is a rare case of prohibited extraterritorial application that lacks *all* contact with the territory of the United States,'' and ''the presumption against extraterritorial application would be a craven watchdog indeed if it retreated to its kennel whenever *some* domestic activity is involved in the case.'' *Morrison*, 130 S. Ct. at 2884 (emphasis in the original). *Morrison* thus rejected plaintiffs' suggestion that deceptive conduct in Florida, rather than a purchase or sale in the United States, brought its claims within the scope of § 10(b). *Id*. at 2883-84.

1. The Absolute Activist Tests for Domestic Transactions in 'Other Securities.' Although *Morrison* did not specify what level of domestic activity would be adequate to trigger the application of Section 10(b), the U.S. Court of Appeals for the Second Circuit recently provided guidance in *Absolute Activist Value Master Fund Ltd. v. Ficeto*, No. 11-0221-cv, 2012 BL 91815, 2012 WL 1232700 (2d Cir. Apr. 13, 2012).[4] *Absolute Activist* held that transactions involving securities not traded on a domestic exchange are domestic if (1) irrevocable liability is incurred, or (2) title transfers, within the United States. *Id*. at *1.

The Second Circuit explained that the ''irrevocable liability'' test was the same standard it previously deployed to determine the timing of a purchase or sale transaction:

> Given that the point at which the parties become irrevocably bound is used to determine the timing of a purchase and sale, we similarly hold that the point of irrevocable liability can be used to determine the locus of a securities purchase or sale. Thus, in order to adequately allege the existence of a domestic transaction, it is sufficient for a plaintiff to allege facts leading to the plausible inference that the parties incurred irrevocable liability within the United States: that is, that the purchaser incurred irrevocable liability within the United States to take and pay for a security, or that the seller incurred irrevocable liability within the United States to deliver a security.

Id. at *7.[5] The Second Circuit also made clear that ''a sale of securities can be understood to take place at the location in which title is transferred'' because ''a 'sale'

[3] *See also Sgalambo v. McKenzie*, 739 F. Supp. 2d 453, 464, 487, 2010 BL 181570 (S.D.N.Y. 2010) (dismissing the claims of ''any potential class members who purchased Canadian Superior common stock on a foreign exchange,'' although the stock also ''was traded on the American Stock Exchange . . . at all times during the class period''); *In re Vivendi Universal S.A. Securities Litigation*, 765 F. Supp. 2d 512, 531, 2011 BL 45228 (S.D.N.Y. 2011) (''There is no indication that the *Morrison* majority read Section 10(b) as applying to securities that may be cross-listed on domestic and foreign exchanges, but where the purchase and sale does not arise from the domestic listing, particularly where (as here) the domestic listing is not even for trading purposes.''); *In re Royal Bank of Scotland Group PLC Securities Litigation*, 765 F. Supp. 2d 327, 336 (S.D.N.Y. 2011) (''The idea that a foreign company is subject to U.S. securities laws everywhere it conducts foreign transactions merely because it has 'listed' some securities in the United States is simply contrary to the spirit of *Morrison*.''); *In re Infineon Technologies AG Securities Litigation*, No. C 04-04156 JW, 2011 WL 7121006, at *3 (N.D. Cal. Mar. 17, 2011) (''Plaintiffs cannot state claims on behalf of individuals who purchased Infineon shares on the Frankfurt Stock Exchange,'' even where the shares were also listed and registered on the NYSE); *In re BP PLC Securities Litigation*, 2012 BL 44655, 80 U.S.L.W. 1111, MDL No. 10-md-2185, Civ. No. 4:10-md-2185, 2012 WL 432611, at *67 (S.D. Tex. Feb. 13, 2012) (where ''shares are registered on the NYSE, but, as Plaintiffs concede, the share never traded on a U.S. exchange . . . Plaintiffs cannot point to the 'domestic transaction,' which must include a 'domestic purchase or sale,' required for section 10(b) liability following *Morrison*'').

[4] *Absolute Activist*, 2012 WL 1232700, amended and superseded an earlier version of the decision issued on March 1, 2012, *Activist Value Master Fund Ltd. v. Ficeto*, 672 F.3d 143, 2012 BL 50533, 80 U.S.L.W. 1188 (2d Cir. 2012), though the two decisions are identical with respect to the points discussed in this article.

[5] *Absolute Activist* cited with approval *Securities and Exchange Commission v. Goldman Sachs & Co.*, 790 F. Supp. 2d 147, 159 (S.D.N.Y. 2011) (dismissing Section 10(b) claims where ''none of the conduct or activities alleged by the SEC, including the closing, constitute facts that demonstrate where any party to the IKB note purchases incurred 'irrevocable liability' ''), and *Plumbers' Union Local No. 12 Pension Fund v. Swiss Reinsurance Co.*, 753 F. Supp. 2d 166, 177, 2010 BL 233016 (S.D.N.Y. 2010) (explaining that ''purchase,'' for purposes of the Exchange Act, has been interpreted ''to make an individual a 'purchaser' when he or she 'incurred an irrevocable liability to take and pay for the stock.' ''). *See also Basis Yield Alpha Fund (Master) v. Goldman Sachs Group Inc.*, 798 F. Supp. 2d 533, 537 (S.D.N.Y. 2011) (requiring a Section 10(b) plaintiff to ''allege that the parties incurred irrevocable liability to purchase or sell the security in the United States,'' and granting leave to replead).

  LW ISSN 0148-8139

is ordinarily defined as '[t]he transfer of property or title for a price.' '' *Id*.[6]

Absolute Activist went on to consider whether the transactions at issue—a foreign hedge fund's purchases of shares of thinly capitalized United States-based companies directly from the issuers pursuant to private offerings—sufficiently alleged purchases in the United States subject to Section 10(b). Because the ''sole allegation'' affirmatively stating that the transactions were domestic was conclusory (the pleading alleged merely that the ''fraudulent transactions that Defendants carried out through Hunter took place in the United States''), the Second Circuit held that the plaintiffs failed to adequately plead ''the existence of domestic transactions,'' but directed the district court to grant leave to amend to give the plaintiff an opportunity to allege ''factual allegations suggesting that the Funds became irrevocably bound within the United States or that title was transferred within the United States, including, but not limited to, facts concerning the formation of the contracts, the placement of purchase orders, the passing of title, or the exchange of money.'' *Id*. at *8-*9.

2. Limited Domestic Activity in Connection with a Transaction in 'Other Securities' Does Not Satisfy Morrison's Second Prong. The factors identified by *Absolute Activist* as relevant to an analysis of whether irrevocable liability was bound or title transferred in the United States track factors considered by other courts applying *Morrison*'s second prong. Not surprisingly, most of these precedents hold that ***limited*** domestic activity relating to an otherwise foreign securities transactions is insufficient to give rise to Section 10(b) liability. Examples of domestic activity held ***insufficient***—standing alone—to establish a domestic transaction ''in other securities'' subject to Section 10(b) liability include:

■ **A foreign securities purchase by a domestic investor.** *See*, *e.g.*, *Absolute Activist*, 2012 WL 1232700, at *8 (''While it may be more likely for domestic transactions to involve parties residing in the United States, '[a] purchaser's citizenship or residency does not affect where a transaction occurs' '') (citation omitted); *In re BP PLC Securities Litigation*, 2012 WL 432611, at *67-*68 (rejecting the argument that the residency of the investors is sufficient to create liability under Section 10(b)); *Cascade Fund LLP v. Absolute Capital Management Holdings Ltd.*, No. 08–cv–01381, 2011 WL 1211511, at *5 (D. Colo. Mar. 31, 2011) (''*Morrison* makes clear that the test of § 10(b)'s reach is not dependent on the fact that domestic investors in foreign securities were harmed by fraud . . . the Supreme Court's analysis takes no account of the residence of the investor.''); *In re Vivendi*, 765 F. Supp. 2d at 532 (''the Court joins other lower courts that have rejected the argument that a transaction qualifies as a 'domestic transaction' under *Morrison* whenever the purchaser or seller resides in the United States, even if the transaction itself takes place entirely over a foreign exchange.'').[7]

■ **A securities transaction solicited in the United States but executed on a foreign exchange.** *See Cascade Fund LLP*, 2011 WL 1211511, at *6 (rejecting ''the proposition that a domestic investor's purchase of foreign stocks on foreign exchanges [were] nevertheless 'domestic transactions' subject to § 10(b) if the issuer solicited the investments in the United States,'' ''particularly where *Morrison* makes no mention whatsoever of the significance of the place of solicitation.''); *Absolute Activist*, 2012 WL 1232700, at *8 (''allegations that the Funds were heavily marketed in the United States and that United States investors were harmed by the defendants' actions, while potentially satisfying the now-defunct conduct and effects test, . . . do not satisfy the transactional test announced in *Morrison*'').

■ **The act of electronically transmitting a purchase order from within the United States for a security sold on a foreign exchange.** *See Plumbers' Union*, 753 F. Supp. 2d at 179 (''For the purposes of determining whether a securities transaction is a 'domestic' transaction under *Morrison*, the country in which an investor happened to be located at the time that it placed its purchase order is immaterial.''); *In re Société Générale*, 2010 WL 3910286, at *6 (''By asking the Court to look to the location of the 'the act of placing a buy order,' and to . . . 'the place of the wrong,' Plaintiffs are asking the Court to apply the conduct test specifically rejected in *Morrison*.''); *In re Alstom*, 741 F. Supp. 2d at 471-72 (finding arguments that foreign securities purchases were ''domestic transactions under *Morrison* because such purchases were initiated in the United States'' unpersuasive).

■ **The subjective intent of the parties.** *See In re Banco Santander Securities Optimal Litigation*, 732 F. Supp. 2d 1305, 1317-18 (S.D. Fla. 2010) (''[L]ooking to the subjective intent of foreign inves-

[6] In making this finding, *Absolute Activist* cited *Quail Cruises Ship Management Ltd. v. Agencia de Viagens CVC Tur Limitada*, 645 F.3d 1307, 1310-11 (11th Cir. 2011) (holding that ''the alleged transfer of title to the shares in the United States'' based on allegations that ''the closing *actually* occurred in the United States'' was not ''beyond § 10(b)'s territorial reach'').

[7] *See also Plumbers' Union*, 753 F. Supp. 2d at 178 (''A purchaser's citizenship or residency does not affect where a transaction occurs'' for Section 10(b) purposes); *In re Société Générale Securities Litigation*, No. 08 Civ. 2495 (RMB), 2010 WL 3910286, at *5 (S.D.N.Y. Sept. 29, 2010) (''Where, as here, domestic plaintiffs purchased shares of a foreign bank traded on a foreign exchange, the Exchange Act is inapplicable[.]''); *Cornwell v. Credit Suisse Group*, 729 F. Supp. 2d 620, 625-26 (S.D.N.Y. 2010) (''§ 10(b) [does] not extend to foreign securities trades executed on foreign exchanges even if purchased or sold by American investors''); *Stackhouse v. Toyota Motor Co.*, No. CV 10-0922 (DSF) (AJWx), 2010 BL 317963, 2010 WL 3377409, at *1 (C.D. Cal. July 16, 2010) (holding '' 'domestic transactions' or 'purchase[s] or sale[s] . . . in the United States' means purchases and sales of securities explicitly solicited by the issuer within the United States rather than transactions in foreign-traded securities where the ultimate purchaser or seller has physically remained in the United States''); *In re Royal Bank of Scotland*, 765 F. Supp. 2d at 337 (''Plaintiffs[']approach—that it is enough to allege that Plaintiffs are U.S. residents who were in the country when they decided to buy RBS shares—is exactly the type of analysis that *Morrison* seeks to prevent.''); *In re Merkin*, 817 F. Supp. 2d 346, 357, n. 10 (S.D.N.Y. 2011) (rejecting the ''argument that *Morrison* does not apply because certain Plaintiffs are U.S. residents'' as ''absurd on its face''); *CLAL Finance Batucha Investment Management Ltd. v. Perrigo Co.*, No. 09 Civ. 2255 (TPG), 2011 WL 5331648 (S.D.N.Y. Sept. 28, 2011) (dismissing §§ 10(b) and 20(a) claims by lead plaintiff who purchased stock on the Tel Aviv Stock Exchange, but permitting substitution of a new lead plaintiff subject to proper allegations that such plaintiff's shares were purchased on the NASDAQ market).

tors to determine whether the securities act applies is clearly contrary to *Morrison*. . . . Adopting the unpredictable and subjective criterion suggested by the Plaintiffs (i.e., a foreign investor's intent to ultimately own United States securities) would eliminate the doctrinal clarity that the Supreme Court provided in *Morrison.''*), *aff'd*, 439 F. App'x 840 (11th Cir. 2011).

■ **The use of a domestic broker-dealer.** *See Absolute Activist*, 2012 WL 1232700, at *7 (''the location of the broker alone does not necessarily demonstrate where a contract was executed'').

3. A Factual Analysis is Required to Establish a Domestic Transaction in 'Other Securities.' By contrast, recent case law suggests that ''irrevocable liability'' will be held to be incurred in the United States where a sufficient domestic nexus is factually alleged. For example, irrevocable liability was held to be incurred domestically where a privately negotiated securities transaction was signed by the plaintiff's CEO in Colorado and faxed to New York, and the defendant's CEO (also a signatory) was in New York to announce the agreement the following day, and ''there is no evidence indicating that he was anywhere else'' when the signature page was received. *Liberty Media Corp. v. Vivendi Universal S.A.*, No. 03 Civ. 2175 (SAS), 2012 WL 1203825, at *4 (S.D.N.Y. Apr. 11, 2012). Similarly, in *Securities and Exchange Commission v. Levine*, No. 10-16238, 2011 BL 322975, 2011 WL 6391917, at *1 (9th Cir. Dec. 21, 2011), the U.S. Court of Appeals for the Ninth Circuit held that sales that ''closed in Nevada when [the defendant] received completed stock purchase agreements and payments'' were subject to Exchange Act liability.

In addition, where several factors suggest that a transaction is (or may be) domestic, authorities suggest that courts will give the plaintiff an opportunity to develop facts that establish the location of the transactions. For example, in *Anwar v. Fairfield Greenwich Ltd.*, 728 F. Supp. 2d 372, 405, 2010 BL 314117 (S.D.N.Y. 2010): [8]

> Defendants argue that, because a number of administrative tasks associated with purchasing shares in the Offshore Funds occurred in other countries—for example, Plaintiffs sent their subscription agreements to an administrator in Amsterdam and the Offshore Funds' investment manager, FGBL, in Bermuda—and because Fairfield Sentry Ltd. was listed on the Irish Stock Exchange, the securities transaction in question did not occur in the United States. Plaintiffs contend that whatever steps happened outside of the United States along the way, no transaction actually occurred until Plaintiffs' subscription agreements were accepted by the Funds, and that this approval occurred in New York City, where FGG had an office and where much of its executive staff was concentrated. Thus, on Plaintiffs' theory, *Morrison* does not bar their § 10(b) claims because the purchase or sale of the covered securities at issue occurred in the United States. The Court also notes that even if Fairfield Sentry Ltd. was listed on the Irish Stock Exchange, its stock was apparently not actually traded there.
>
> As this case allegedly does not involve securities purchases or sales executed on a foreign exchange, it presents a novel and more complex application of *Morrison*'s transactional test. Given the uniqueness of the financial interests, structure of the transactions and relationships among the parties, the Court finds that a more developed factual record is necessary to inform a proper determination as to whether Plaintiffs' purchases of the Offshore Funds' shares occurred in the United States.

Id. at 405 (citations omitted).

Similarly, the defendants in *In re Optimal U.S. Litigation*, 813 F. Supp. 2d 351, 2011 BL 116673 (S.D.N.Y. 2011), *reconsideration granted in part on other grounds*, 813 F. Supp. 2d 383, 2011 BL 220291 (S.D.N.Y. 2011), moved to dismiss Section 10(b) claims based on private placement transactions on behalf of foreign plaintiffs who invested in a foreign Madoff-feeder fund. There, ''[d]rawing all reasonable inferences in Plaintiffs' favor,'' the district court concluded that the allegation that the purchases were domestic was ''factually supported by the Contract Notes'' before it which read ''WE BOUGHT [SOLD] FOR YOUR ACCOUNT IN: NYS,'' and stated that the defendants' argument, ''while promising, is better-suited for a motion for summary judgment in the context of a more fully-developed factual record.'' *Id*. at 373.[9] *See also Securities and Exchange Commission v. Ficeto*, 2011 WL 7445580, at *13 (''[P]rivately negotiated purchases between individually contracting parties, one of whom is foreign and the other domestic, that are not made on the open market cannot automatically be considered domestic *or* foreign transactions. For such transactions, it makes more sense to closely examine the details of the transaction—as courts have done—to determine whether the transaction could reasonably be considered a domestic transaction.'') (emphasis in original); *Horvath v. Banco Comercial Portgues S.A.*, No. 10 Civ. 4697 (GBD), 2011 WL 666410, at *3 (S.D.N.Y. Feb. 15, 2011) (where the transactions ''involve the purchasing of shares of German banks through Luxembourg and Island of Jersey . . . by BCP, a Portuguese bank,'' the transactions ''fall outside'' of Section 10(b) and must be dismissed), *aff'd*, No. 11-1058-cv, 2012 BL 37764, 2012 WL 49726 (2d Cir. Feb. 16, 2012); *Aaes v. 4G Cos.*, No. H-11-975, 2012 BL 65917, 2012 WL 949040, at *7 (S.D. Tex. Mar. 20, 2012) (dismissing Section 10(b) claim whether ''the facts that the Plaintiffs have alleged indicated that every transaction underlying this case was entirely foreign,'' including that ''Plaintiffs are all foreign citizens and, it appears, were at all relevant times in foreign countries . . . [and t]here is no indication that any of the transactions in this case took place domestically.'').

C. Special Issues

1. American Depositary Receipt Transactions under Morrison's First and Second Prong. Courts considering the application of Section 10(b) to trades in American Depositary Receipt (ADR) certificates representing stock of foreign companies sold in the United States[10]—both be-

[8] Reconsideration of *Anwar* was repeatedly denied. *See* 09 CIV 0118 VM, 2010 WL 3834054 (S.D.N.Y. Sept. 13, 2010), 09 CIV 0118 VM, 2010 WL 3834057 (S.D.N.Y. Sept. 13, 2010), 09 CIV 0118 VM, 2010 WL 3834052 (S.D.N.Y. Sept. 20, 2010), and 800 F. Supp. 2d 571 (S.D.N.Y. 2011).

[9] As of April 18, 2012, the parties in *In re Optimal* had briefed whether the standard enunciated in *Absolute Activist Value Master Fund Ltd.*, 672 F.3d 143, required dismissal, and the issue was *sub judice*. *See Rembaum v. Banco Santandar S.A.*, No. 1:10-cv-04095-SAS (S.D.N.Y.), Nos. 123, 134 and 135.

[10] ''The stocks of most foreign companies that trade in the U.S. markets are traded as American Depositary Receipts (ADRs) issued by U.S. depositary banks.'' *See* U.S. Securities

   ISSN 0148-8139

fore and after *Morrison*—have observed that such transactions are ''predominantly foreign.'' *See, e.g.*, (1) before *Morrison*: *In re SCOR Holding (Switzerland) AG Litigation*, 537 F. Supp. 2d 556, 561 (S.D.N.Y. 2008) (assuming purchases of foreign stock through ADRs on the NYSE were ''predominantly foreign securities transactions''); *Copeland v. Fortis*, 685 F. Supp. 2d 498, 506, 2010 BL 37537 (S.D.N.Y. 2010) (Trade in ADRs is considered to be a ''predominantly foreign securities transaction.'') (citing *In re SCOR*); *Cornwell v. Credit Suisse Group*, 666 F. Supp. 2d 381, 395 (S.D.N.Y. 2009) (same); (2) after *Morrison*: *In re Société Générale*, 2010 WL 3910286, at *6-*7 (same); *In re Royal Bank of Scotland*, 765 F. Supp. 2d at 335 (same).

Notwithstanding the ''predominantly foreign'' character of ADR securities trades, post-*Morrison* courts (and litigants) have consistently recognized that plaintiffs who purchased ADRs *on domestic exchanges* have recourse to Section 10(b) claims under *Morrison*'s first prong. For example, *In re Vivendi*, 765 F. Supp. 2d at 521, included U.S. and foreign shareholders of a foreign media corporation's ordinary shares or ADRs representing those shares, where the ordinary shares ''did not trade on any U.S. exchange,'' but the ADRs were listed and traded on the NYSE. There, the court held that the registration of ordinary Vivendi shares with the SEC, together with a lesser fixed amount of ordinary shares actually listed with the NYSE in connection with the ADRs, was not an adequate basis to apply Section 10(b) to *all* ordinary shareholders; however, the ''parties agree[d] that *Morrison* has no impact on the claims of the ADR purchasers since Vivendi's ADRs were listed and traded on the NYSE.'' *Id*. at 527. *See also In re Royal Bank of Scotland*, 765 F. Supp. 2d at 337 (where the complaint asserted ''Exchange Act claims encompassing purchasers of American Depository Receipts . . . which trade on the New York Stock Exchange,'' ''Defendants admit that under *Morrison*, trades on the NYSE fall within the territorial ambit of the Exchange Act''); *Cornwell*, 729 F. Supp. 2d at 622 (where plaintiffs purchased ADSs on the NYSE *and* ordinary shares from on the Swiss Stock Exchange, a motion to dismiss only the latter non-ADS plaintiffs from maintaining their claims was granted).[11]

The application of Section 10(b) to ADRs purchased *on the over-the-counter market* is far less certain. At least according to *In re Société Générale*, 2010 WL 3910286, at *7-*8, which dismissed Section 10(b) claims based on over-the-counter ADR purchases *sua sponte*, they do not comprise ''domestic transaction in other securities'' under *Morrison*'s second prong. *In re Société Générale* explained:

> As noted, even though defendants do not argue that UFCW's claims should be dismissed under *Morrison*, the court concludes that the Exchange Act is inapplicable to UFCW's ADR transactions. That is, the court finds that, because ''[t]rade in ADRs is considered to be a 'predominantly foreign securities transaction,'' 'Section 10(b) is inapplicable. . . . SocGen's ADRs ''were not traded on an official American securities exchange; instead, ADRs were traded in a less formal market with lower exposure to U.S.-resident buyers.'' Trade in SocGen ADRs is a ''predominantly foreign securities transaction.''

Id. at *7 (citations omitted). It is uncertain whether this analysis survives the ''irrevocable liability'' and ''title transfer'' tests subsequently outlined in *Absolute Activist*, particularly given the Second Circuit's observation that ''we cannot conclude that the identity of the security necessarily has any bearing on whether a purchase or sale is domestic within the meaning of *Morrison*.'' *Absolute Activist*, 2012 WL 1232700, at *7 (''The second prong of that test refers to 'domestic transactions in other securities,' not 'transactions in domestic securities' or 'transactions in securities that are registered with the SEC.' '') (citations omitted).

2. Foreign vs. Domestic Linked Derivative Securities. Cases considering the application of Section 10(b) to derivative securities traded over-the-counter or by private placement faces special challenges in determining whether such transactions are domestic for the purposes of *Morrison*'s second prong. Independent of the factors informing the locus of the transaction identified by *Absolute Activist*, 2012 WL 1232700, at *8-*9, pre-*Absolute Activist* authorities started to fashion an ''economic reality'' approach to determine whether a derivative transaction is foreign or domestic by taking into account whether the underlying instrument itself is foreign or domestic.

For example, in *Elliott Associates v. Porsche Automobil Holding SE*, 759 F. Supp. 2d 469, 470, (S.D.N.Y. 2010), the plaintiffs ''entered into securities-based swap agreements that referenced the share price of another German car company, Volkswagen.'' The swap agreements were ''privately negotiated contracts . . . not traded on any exchanges'' that ''fluctuated in value as the price of VW shares rose or fell.'' *Id*. at 471. Citing precedents that held that the location of the act of placing a buy order for securities traded abroad was not sufficient to bring a transaction within the ambit of Section 10(b), the district court queried ''whether there is any distinction, for the purposes of § 10(b), between a domestic 'buy order' for securities traded abroad and one party's execution in the U.S. of a swap agreement that references foreign securities.'' *Id*. at 475. The district court concluded that the answer was no, as follows:

> Here, the parties agree that plaintiffs' swap agreements, which reference VW shares, were economically equivalent to the purchase of VW shares. Plaintiffs even allege that ''the swap agreement[s] generated gains as the price of VW shares declined and generated losses as the price of VW shares rose, *achieving an economic result similar to a short sale*.'' Since the economic value of securities-based swap agreements is intrinsically tied to the value of the reference security, the nature of the ref-

& Exchange Commission, International Investing, http://www.sec.gov/investor/pubs/ininvest.htm. An ADR ''represents one or more shares of a foreign stock or a fraction of a share.'' *Id*. The terms ADR and ADS are sometimes used interchangeably, but an ADR is ''the negotiable physical certificate that evidences ADSs,'' whereas ''an ADS is the security that represents an ownership interest in deposited securities.'' *Id*.

[11] *See also In re Elan Corp. Securities Litigation*, No. 08 Civ. 8761 (AKH), 2011 WL 1442328, at *1 (S.D.N.Y. Mar. 18, 2011) (''As to purchases of American Depositary Receipts [ ] or call options on such ADRS, I hold that *Morrison* does not compel dismissal at the pleadings stage.''); *Stackhouse*, 2010 WL 3377409, at *2 (''the Court is inclined to appoint the proposed lead plaintiff with the largest alleged American Depository Share [ ] loss'' post-*Morrison*); *In re BP PLC Securities Litigation*, 2012 WL 432611, at *69 (granting motion to dismiss Section 10(b) claims brought by BP ordinary shareholders ''[b]ecause Plaintiffs cannot point to a domestic transaction involving BP ordinary shares,'' but leaving claim otherwise adequately pleaded by ADR holders intact).

> erence security must play a role in determining whether a transnational swap agreement may be afforded the protection of Section 10(b). Here, plaintiffs' swaps were the functional equivalent of trading the underlying VW shares on a German exchange. Accordingly, the economic reality is that plaintiffs' swap agreements are essentially ''transactions conducted upon foreign exchanges and markets,'' and not ''domestic transactions'' that merit the protection of Section 10(b). . . . 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 *Morrison*'s presumption against extraterritoriality on its head.

Id. at 476 (citations omitted) (emphasis in original).

Valentini v. Citigroup Inc., No. 11 Civ. 1355 (LBS), 2011 WL 6780915, at *14 (S.D.N.Y. Dec. 27, 2011), applied a similar ''economic reality'' approach to determine the application of Section 10(b) to ''securities that were linked to domestically-traded, rather than foreign-traded securities.'' Because the value of the notes at issue in *Valentini* ''rose and fell as the price of the [NYSE-traded] shares to which they were linked rose and fell,'' and ''at least some of the notes were also convertible into those securities,'' the district court found that ''when Plaintiffs purchased these convertible notes, they were in effect purchasing a put option on those NYSE-traded stocks.'' *Id*. Reasoning that ''at least some of the transactions at issue in this case—namely, those that involved convertible securities—constitute 'transactions involving securities traded on domestic exchanges' '' that satisfied *Morrison*'s second prong, the court left it ''to a later state in the litigation to determine which of the notes at issue in this case were convertible products, and therefore subject to the jurisdiction of Section 10(b), and which were not.'' *Id*.[12]

Not all cases involving derivatives have applied this ''economic reality'' approach. For example, in *Terra Security ASA Konkursbo v. Citigroup Inc.*, 740 F. Supp. 2d 441, 447 (S.D.N.Y. 2010), *aff'd*, 450 F. App'x 32 (2d Cir. 2011), the District Court revisited its early decision denying dismissal of federal securities claims involving transactions in fund linked notes (''FLNs'') linked to the Citi Tender Option Bond Fund and listed on European stock exchanges, as well as a fund-linked ''Total Return Swap'' (''TRS'') agreement involving FLNs linked to the defendants Offshore Tender Option Bond Fund after *Morrison* was decided. Noting that the parties ''agreed that *Morrison* [was] controlling'' and ''that the FLNs that plaintiff purchased were listed on European stock exchanges and that the TRS was sold in Europe,'' the District Court dismissed claims pursuant to Sections 10(b) and 20(a) without addressing whether the result might differ for FLNs linked to domestic, versus foreign, securities. *See id*.

In the wake of *Absolute Activist*, and the Second Circuit's express statement that the identity of the security—as distinct from the locus the relevant trade—may have no bearing ''on whether a purchase or sale is domestic,'' *Absolute Activist*, 2012 WL 1232700, at *7, it remains to be seen whether the ''economic reality'' approach will be one of the factors used to determine the locus of derivative transactions in privately place or over the market transactions.

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[12] *See also Securities and Exchange Commission v. Compania Internacional Financiera S.A.*, No. 11 Civ. 4904 (DLC), 2011 BL 198071, 2011 WL 3251813, at *6 (S.D.N.Y. July 29, 2011) (holding that alleged insider trading of contracts for difference purchased in the United Kingdom but referencing shares traded on the NYSE were within the reach of Section 10(b) under *Morrison*: ''Even though Chartwell may have engaged in this insider trading by trading CFDs in London that were tied to transactions on the NYSE in Arch's domestic securities, this does not negate the fact that its alleged deceptive conduct involved securities listed on a domestic exchange.''). *Cf.*, *Securities and Exchange Commission v. Wyly*, 788 F. Supp. 2d 92, 120-21, 2011 BL 86994 (S.D.N.Y. Mar. 31, 2011) (finding that foreign trading of a swap agreement which referenced a domestic security to be purchased or sold by the broker of the swap agreement constituted a fraudulent device undertaken ''in connection with'' the purchase or sale of securities under Section 10(b) and Rule 10b-5).

   ISSN 0148-8139