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Morrison and Dodd-Frank's Extraterritoriality Dilemma

Law360, New York (November 30, 2010) -- In Morrison v. National Australia Bank Ltd., the U.S. Supreme Court addressed the extraterritorial reach of Section 10(b) of the Securities Exchange Act. In that case, the Supreme Court addressed so-called "f-cubed" Section 10(b) claims — foreign plaintiffs suing foreign defendants in connection with securities traded on foreign exchanges.

The Exchange Act is silent as to its extraterritorial application, and enterprising foreign plaintiffs were attempting to use it to gain access to the broad discovery and class action procedures that U.S. law provides, but that many other legal regimes do not.

In Morrison, the Supreme Court reaffirmed the presumption that "when a statute gives no clear indication of extraterritorial application, it has none." The court held that Section 10(b) of the Securities Exchange Act applies to fraud "only in connection with the purchase or sale of a security listed on an American stock exchange and the purchase or sale of any security in the United States."

Notably, the court specifically rejected the so-called "conduct" and "effects" tests previously adopted by the circuit courts, including the Second Circuit, to resolve questions of extraterritorial jurisdiction of the securities laws.

Recently, lower courts have extended the reasoning of Morrison beyond securities cases. In Cedeno v. Intech Group Inc. for instance, Judge Jed Rakoff of the Southern District Court of New York dismissed a Racketeer Influenced and Corrupt Organization claim brought by a foreign plaintiff against foreign defendants in a U.S. court.

Though Morrison addressed the extraterritorial reach of only Section 10(b), Judge Rakoff found its reasoning applicable to the RICO statute, which, like Section 10(b), is silent as to its extraterritorial application. Judge Rakoff concluded that RICO "is focused on how a pattern of racketeering affects an enterprise" and evidences no concern with extraterritorial conduct "sufficiently clear to overcome the presumption against extraterritoriality."

In a footnote, the judge noted that prior Second Circuit case law had rejected arguments limiting RICO's extraterritorial reach because it had found "no indication that Congress intended to limit [RICO] to infiltration of domestic enterprises." He concluded that this case, Alfadda v. Fenn, 935 F.2d 475 (2d Cir. 1991), was no longer good precedent in light of the Supreme Court's decision in Morrison.

Shortly after the court's ruling in Cedeno, the Second Circuit, relying on Morrison, also affirmed the dismissal of a RICO claim brought by a foreign plaintiff against foreign defendants in a U.S. court. In Norex Petroleum Ltd. v. Access Industries Inc., the Second Circuit expressly found that, because RICO is silent as to any extraterritorial application, the presumption against extraterritoriality articulated in Morrison applies to RICO claims.

Interestingly, the Second Circuit made no mention of its prior holding in Alfadda.

The Dodd-Frank Act revived extraterritorial application of the anti-fraud provisions of the securities laws by authorizing actions involving "conduct within the U.S. that constitutes significant steps in furtherance of a violation" or "conduct occurring outside the U.S. [that] has a foreseeable substantial effect within the U.S." — but only for actions brought by the U.S. Securities and Exchange Commission.

Private “f-cubed” actions remain foreclosed by Morrison. It should be noted, however, that the Dodd-Frank Act requires the SEC to “solicit public comment and conduct a study to determine the extent to which private rights of action” should be permitted to have extraterritorial effect.

In its amicus brief submitted in Morrison, the SEC advocated that the extraterritorial application of federal securities laws to private litigants be extended to circumstances where the transnational securities fraud involves “significant and material conduct” in the U.S. and there is a “direct link” between the litigant’s injury and the U.S. component of the fraud.

It will be interesting to see whether the SEC’s position evolves in light of the court’s holding in Morrison and the SEC’s upcoming study on this issue.

For the moment, however, it is important to note that Morrison not only continues to bar “f-cubed” litigation by private litigants under the Exchange Act, but also appears to be having the collateral effect of limiting the extraterritorial application of other federal statutes as well.

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