



Ruling Calls Into Question Investors' Reliance on U.S. Securities Laws in Foreign Transactions (taken from Council Governance Alert, July 1st issue)

The principal antifraud provisions of the U.S. securities laws apply only to stock transactions in the United States or to stock transactions in companies listed on U.S. exchanges, the U.S. Supreme Court ruled in *Morrison v. Australia Bank* on June 24. Previously, a number of Federal Court of Appeals rulings had held that U.S. securities laws applied in cases either if there was substantial wrongful conduct in the United States or wrongful conduct that had a substantial effect in the United States or on U.S. citizens.

The justices ruled 8-0 against three Australian residents who sued over the bank's disclosures to investors about losses incurred by a U.S. subsidiary. The plaintiffs purchased ordinary shares of National Australia Bank on the Australian Stock Exchange. The bank's stock is traded on the Australian exchange and other foreign securities exchanges, but not on any exchange in the United States. The plaintiffs argued unsuccessfully that U.S. securities laws applied in the case because the fraud occurred in the United States. They said the bank's annual reports materially misrepresented the financial condition of its subsidiary HomeSide Lending, a former Florida-based subsidiary that forced the Australian bank to take a \$1.75 billion write-down.

In previous rulings, the district court dismissed the action for lack of subject-matter jurisdiction because the acts alleged to have taken place in the United States were "at most, a link in the chain of an alleged overall securities fraud scheme that culminated abroad." The Second Circuit affirmed on similar grounds, concluding that the acts performed in the United States did not comprise the "heart of the alleged fraud."

The Supreme Court found that the anti-fraud provisions in U.S. securities laws apply "only to transactions in securities listed on domestic exchanges and domestic transactions in other securities." Furthermore, it said plaintiffs can no longer bring securities fraud suits in U.S. courts against companies listed solely on foreign exchanges.

"The practical impact on institutional investors is that they can be wooed here by major foreign corporations to invest with them, but if aggrieved, they have to go abroad to seek their remedy," said Barbara Hart, head of the securities litigation practice at Lowey Dannenberg Cohen and Hart. "The larger ramification of this decision is its impact on investment decisions. Can fund fiduciaries invest overseas when arguably or practically, they have little or no recourse if fraud occurs? It will be interesting to see as this decision is digested whether institutional investors will now analyze the risk of securities fraud coupled with the costs of litigating overseas as part of the investment metric, like political instability or climate risk," she added.

The Court's ruling is consistent with rulings over the past several years that have restrained the scope of U.S. securities laws. Responding to arguments that the United States may become a "Barbary Coast" for those perpetrating frauds on foreign securities markets, the Court observed that "some fear that it has become a Shangri-La of class-action litigation for lawyers representing those allegedly cheated in foreign securities markets."

The issue of the U.S. securities law's extraterritoriality is addressed in the sweeping financial regulatory reform bill on the cusp of being signed into law. The legislation reaffirms right of the U.S. government and the SEC to use U.S. securities laws to file suit in cases in which stock transactions occur outside the United States and involve only foreign investors. The bill also calls for the SEC to conduct a study to determine how far U.S. securities laws should be extended to allow private investors to file suit in cases that involve stock transactions occurring outside the United States and involving only foreign investors.