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APPLICATION OF US SECURITIES FRAUD LAW IN CROSS-BORDER TRANSACTIONS

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As business and commerce continue to globalize, it is becoming increasingly important to know just how far abroad United States law can apply. Money moves internationally these days at the speed of light and in enormous sums, so it is particularly crucial to know what the reach is of American financial regulation. The law on this is still a bit unsettled, especially since the United States Supreme Court decision two years ago in *Morrison v. National Australia Bank*, -- U.S. --, 130 S.Ct. 2869 (2010), but the edges of the outlines have started to come into view recently. A decision a few weeks ago from the United States Court of Appeals for the Second Circuit (the circuit that includes New York) provides part of the outline.

Morrison was a securities fraud case brought in the United States by Australians against an Australian company publicly traded in Australia. The Supreme Court held in *Morrison* that American securities laws presumptively do not apply outside the United States. Rather, United States securities regulation covers "only transactions in securities listed on domestic exchanges, and domestic transactions in other securities." *Morrison*, slip op. at 18. There is more to *Morrison* than just that, of course, but that is the key holding: no securities fraud claims in the United States unless the shares are registered here or the transaction took place here.

It is usually easy enough to tell whether securities are listed on an exchange in the United States. But how can we tell when a transaction in securities that aren't publicly traded on an American exchange is a "domestic transaction?" There are many possibilities. Does at least one of the parties have to be American? Does the negotiation have to take place in the US? Does the closing have to be in the US? Can parties to a transaction in privately held securities specify in their contract the location where their transaction took place, or will courts make their own determination of where the transaction occurred? How much United States contact is needed for a private securities transaction to be a "domestic transaction?"

The Second Circuit in the last few weeks has taken a first step toward defining a "domestic transaction." In *Absolute Activist Value Master Fund Ltd. v. Ficeto*, -- F.3d --, 2012 WL 1232700 (2d Cir. 2012),[1] the plaintiffs were foreign-based hedge funds that had engaged the US-based defendants as their investment managers. Many of the investors in the funds were Americans. According to the complaint, the defendants had subjected the funds to "pump and dump" schemes and manipulative trading that generated fees for the managers while causing the funds to buy assets at artificially inflated prices. The funds sued for securities fraud under § 10(b) of the Securities Exchange Act of 1934 and its associated Rule 10b-5.

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[1] This opinion was first issued on March 1, and amended on April 13.

In the district court the defendants moved to dismiss the complaint. The day after oral argument on the motion to dismiss, the Supreme Court decided *Morrison*. The district court then dismissed the case on its own motion. The plaintiffs appealed.

On appeal, the Second Circuit focused in on the kinds of transactions that § 10(b) applies to – specifically, § 10(b) prohibits fraud "in connection with the purchase or sale of any security." "Purchase or sale" is the key. So if we can define where a purchase or sale takes place, we can know whether a transaction is domestic.

The 1934 Act defines "purchase" and "sale" to include not just completed transactions but also contracts to buy and sell. Based on that, other case law suggests that a purchase or sale occurs when the parties are "committed" to each other or, in other words, when there is a meeting of the minds. So if the parties had a meeting of the minds in the United States, the transaction on which they had the meeting of minds is a "domestic transaction" and thus subject to § 10(b)/Rule 10b-5.

There is another way a securities transaction can be a domestic transaction, and that is by passing title in the United States. A "sale," after all, is a transfer of title in return for consideration. So if title to the securities passes in the United States, the transaction is within the scope of § 10(b). In sum, therefore, according to the Second Circuit, "transactions involving securities that are not traded on a domestic exchange are domestic if irrevocable liability is incurred or title passes within the United States." *Absolute Activist*, slip op at 8.

This decision is, of course, only the beginning of litigation on this issue. In a wired world, with instantaneous cross-border communications and huge volumes of international trading, the prospect of defining where a meeting of the minds took place is likely to generate a substantial amount of litigation in the coming years. But at least the outer edges are clear now. Contact with the United States is not enough. In a case where securities aren't traded on a US exchange, § 10(b) can apply only if the transaction actually occurs here – whatever that may mean. Obviously there is going to be a fair amount of litigation to establish what it means to have a transaction occur in the United States.

As for the Absolute Activist Value Master Fund and its co-plaintiffs -- the parties whose case led to this Second Circuit decision -- the Second Circuit gave them a do-over. It remanded the case to the district court, with instructions to permit the plaintiffs to amend their complaint so they could try to come within the rules announced on the appeal.

I have some ideas about which issues the next rounds of litigation on this subject will address. If you want to talk about it or if you have any questions about the *Absolute Activist* case, feel free to give me call at (212) 981 2326, or email me at sriback@wilkauslander.com.