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Commercial Litigation

May 2014

City of Pontiac: Second Circuit Further Limits When US Securities Laws May Reach Non-US Securities and Issuers

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In *City of Pontiac Policemen's and Firemen's Retirement System v. UBS AG ("City of Pontiac")*,[1] the US Court of Appeals for the Second Circuit clarified an earlier ruling and further limited when US securities laws may reach non-US securities and issuers. Addressing two issues of first impression, the Court held that for purposes of a claim under Section 10(b) of the Securities Exchange Act of 1934, purchasing securities on a foreign exchange is not a "domestic" US securities transaction just because (i) the foreign security is cross-listed on a US exchange or (ii) the purchase order was placed with a US broker. This ruling provides welcome clarity for non-US companies issuing securities on non-US exchanges, but also highlights the significant questions to be considered in this rapidly evolving area of the law.

Morrison, Absolute Activist, and "Domestic" Transactions Under Section 10(b)

In its groundbreaking decision *Morrison v. National Australia Bank Ltd.*,[2] the US Supreme Court held that Section 10(b) does not apply extraterritorially and established new standards for when securities fraud claims can reach abroad. Under *Morrison*'s "transactional test," Section 10(b) applies only to "domestic" transactions, which are defined as either "transactions in securities listed on domestic exchanges" or "domestic transactions in other securities."[3]

In *Absolute Activist Value Master Fund Ltd. v. Ficeto*, the Second Circuit then considered what constitutes a "domestic transaction in other securities" under *Morrison*.[4] *Absolute Activist* held that a "domestic" transaction subject to Section 10(b) is one where (i) a party incurs "irrevocable liability" within the United States to purchase or deliver a security or (ii) title to a security is transferred within the United States.[5] Since *Morrison* and *Absolute Activist*, securities plaintiffs have advanced various arguments in an effort to make their transactions sufficiently "domestic" to comply with *Morrison*—especially in cases involving non-US issuers and non-US securities. *City of Pontiac* considered and rejected two such arguments.

1 No. 12-4355-cv, Slip Op. (2d Cir. May 6, 2014).

2 130 S. Ct. 2869 (2010).

3 *Id.* at 2884.

4 677 F.3d 60 (2d Cir. 2012).

5 *Id.* at 68.

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Clarifying *Absolute Activist* and Narrowing the Scope of "Domestic" Transactions

The *City of Pontiac* plaintiffs were foreign and domestic institutional investors who invested in UBS shares during 2003 – 2009. The investors alleged that UBS had misrepresented its mortgage-backed securities and collateralized debt obligation exposure, as well as its compliance with certain US tax and securities laws. UBS's ordinary shares were listed on foreign exchanges and cross-listed on the New York Stock Exchange. In affirming dismissal of the case as to all plaintiffs who purchased shares on foreign exchanges,[6] the Second Circuit considered both prongs of *Morrison*'s standards for the extraterritorial application of US securities laws.

Cross-Listed Shares: The Second Circuit first considered the investors' argument that, even though they purchased UBS shares on foreign exchanges, since the same UBS shares were cross-listed on the New York Stock Exchange, the transactions were "transactions in securities listed on domestic exchanges" under *Morrison*'s first prong. This argument had been advanced in a number of post-*Morrison* cases and has come to be known as the "listing theory." The Court noted that *Morrison* expressly focused on "purchases and sales of securities in the United States" and that this meant that the key analytical factor is the location of the securities *transaction* at issue and not the exchange where a security may be dually listed.[7] As such, the Court found the listing theory "irreconcilable with *Morrison* read as a whole" and insufficient to render plaintiffs' purchases on foreign exchanges subject to Section 10(b).[8]

Purchases "Through" the United States: The Second Circuit then considered the argument of a US investor who purchased UBS shares on a foreign exchange by issuing a "buy order" to a US broker. The investor argued that placing an order with a US broker meant that it had "incur[red] irrevocable liability to carry out the transaction" in the United States within the meaning of *Absolute Activist*.[9] The court rejected this argument, holding that the "mere placement of a buy order in the United States for the purchase of foreign securities on a foreign exchange" cannot establish that a purchaser incurred irrevocable liability in the United States to support a claim under Section 10(b) of the Securities Exchange Act.[10]

Implications

City of Pontiac clarifies and refines how US securities laws may relate to transactions on foreign exchanges. The decision should be particularly welcome to foreign issuers that dually list on foreign exchanges and a US exchange, including foreign issuers trading only through foreign clearing systems. In declining to adopt the "listing theory," the Second Circuit eliminated an interpretation of *Morrison*'s "domestic exchange" prong that would have expanded extraterritorial application of Section 10(b). To an even greater extent, by refusing to allow a buy order to a US broker to establish a "domestic transaction," the Second Circuit limited its ruling in *Absolute Activist* so as not to "domesticate" every transaction involving foreign securities that just happened to begin with a US buy order—which would have created a significant loophole for extraterritorial claims under the US securities laws.

At the same time, *City of Pontiac* leaves open what facts would show that "irrevocable liability to carry out the transaction" was incurred in the United States so as to support a claim under Section 10(b). *City of Pontiac* reiterated a list of factors originally set out in *Absolute Activist* that "may be relevant," including "facts concerning the formation of the contracts, the placement of purchase orders, the passing of title or the exchange of money."[11] Thus, *City of Pontiac* tells us only what will *not* satisfy this standard, not what will. US federal courts will undoubtedly continue to grapple with this question in future cases.

6 The claims of plaintiffs who purchased UBS shares on the New York Stock Exchange, and claims made under the Securities Act of 1933, were dismissed on other grounds.

7 Slip Op. at 12 – 13. The Swiss and UK governments filed amicus briefs in the Second Circuit arguing that the listing theory was inconsistent with *Morrison* and threatened to interfere with the respective regulation of their own securities markets.

8 *Id.* at 12.

9 *Id.* at 15.

10 *Id.*

11 Slip Op. at 16 n.33.

The authors gratefully acknowledge the work of Kim Haviv and Joshua Elmore on this alert.

NY0514/CL/A/09373_4