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ALERT MEMORANDUM

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SECOND CIRCUIT AFFIRMS DISMISSAL OF SECURITIES FRAUD CLAIMS AS IMPERMISSIBLY EXTRATERRITORIAL

In *Parkcentral Global Hub Ltd. v. Porsche Automobile Holdings SE*,[1] the Court of Appeals for the Second Circuit construed the Supreme Court's decision in *Morrison v. National Australia Bank Ltd.* as precluding the application of Section 10(b) to certain securities-based swap agreements executed in the U.S. In *Morrison*, the Supreme Court held that Section 10(b) applied only to transactions in securities listed on a U.S. exchange or to domestic purchases and sales of other securities. *Parkcentral* makes clear that the *Morrison* requirements are necessary for Section 10(b) to apply, but may not be sufficient. Indeed, even though the securities transactions at issue in *Parkcentral* were domestic, the Circuit held they were not within Section 10(b)'s reach because of the "predominant" role played by extraterritorial conduct. Thus, the Second Circuit elaborated on the strictures of *Morrison* requiring a domestic transaction but also established a further fact-intensive test that it viewed as consistent with the underlying thrust of the Supreme Court decision.

Background

In *Parkcentral*, funds essentially took short positions in securities-based swap agreements that referenced VW stock (which trades only on foreign exchanges), betting that the stock price would decline. Their complaints alleged that through manipulative actions and misstatements, Porsche concealed its intention to acquire VW, and that Plaintiffs relied on Porsche's statements when entering the swap agreements. When Porsche revealed its plan to take over VW, the price of VW shares skyrocketed and Plaintiffs suffered losses.

Attempting to invoke Section 10(b), Plaintiffs alleged that they entered into the swap agreements in the United States with U.S.-based counterparties, and that the agreements contained New York choice-of-law provisions and forum selection clauses. They did not, however, allege that Porsche was a party to the swap agreements, that its deceptive conduct occurred primarily in the U.S. (although Plaintiffs alleged that certain statements were made in the U.S. or were available here), or that the referenced VW shares were traded on a U.S. exchange. The District Court dismissed, holding that Section 10(b) did not apply because "Plaintiffs' swaps were the functional equivalent of trading the underlying VW shares on a German exchange" and those shares were not traded in the U.S. or on a U.S. exchange.

[1] --- F.3d ----, 2014 WL 3973877 (2d Cir. Aug. 15, 2014).

Second Circuit's Opinion

The Second Circuit affirmed, but followed a different path in doing so. The Circuit first rejected the argument that the situs of transactions – here the securities-based swap agreements – was determinative of whether the claim was extraterritorial under *Morrison*; applying that principle here "would subject to U.S. securities laws conduct that occurred in a foreign country, concerning securities in a foreign company, traded entirely on foreign exchanges, in the absence of any congressional provision addressing the incompatibility of U.S. and foreign law nearly certain to arise" – a result *Morrison* "plainly did not contemplate and . . . does not . . . permit." It next concluded that whether a swap transaction effected in the United States fell within *Morrison*'s scope depended on the facts and circumstances and could not be decided based on any bright line rule. Thus, while a domestic transaction is a necessary element of a Section 10(b) claim, it is not sufficient on its own to bring a particular claim within the confines of Section 10(b). Rather, the Circuit held that whether conduct – some of which took place abroad – would be sufficient to invoke Section 10(b) where there was a security transaction in the U.S. depended on whether the Plaintiffs' claims were so "predominantly foreign as to be impermissibly extraterritorial."[2] The Court held that, on the facts pleaded, the Plaintiffs did not plead a transaction that was sufficiently domestic to satisfy Section 10(b).

Explaining why merely satisfying the twin test in *Morrison* was not sufficient to confer Section 10(b)'s application, the Circuit reasoned that applying Section 10(b) on the facts pleaded would create the "potential for regulatory and legal overlap" with foreign laws that is at odds with the text of the Exchange Act.[3] For example, allowing Plaintiffs to avail themselves of Section 10(b) would "permit the plaintiffs, by virtue of an agreement independent from the reference securities, to hale the European participants in the market for German stocks into U.S. courts and subject them to U.S. securities laws." Indeed, the conflict with foreign law was already palpable, because the allegedly fraudulent acts at issue were the subject of investigation by German regulatory authorities and court proceedings in German courts.

Implications of *Parkcentral*

- So far the Court of Appeals has rejected using the identity of the securities, the identities of the buyer and seller, the identity of the broker, and the location of the transaction as determinative of whether a securities transaction is domestic under *Morrison*.

- A domestic securities transaction is a necessary, but not sufficient, justification for applying Section 10(b). It remains unclear, however, what is "sufficient."

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[2] Stressing the fact-intensive nature of the analysis it employed, the Circuit questioned whether the "potential for incompatibility between U.S. and foreign law" would be a significant factor in future cases, and advised litigants to be wary of attempting to apply *Parkcentral* to other cases "based on the perceived similarity of a few facts."

[3] *See also* Brief of the Securities Industry and Financial Markets Association and the Chamber of Commerce of the United States of America as *Amici Curiae* Supporting Defendants-Appellees, *Viking Global Equities LP v. Porsche AG Wendelin Wiedeking*, at 17-24, 11-397-cv(L), 11-403-cv(CON), 11-416-cv(CON), 11-418-cv(CON), 11-428-cv(CON), 11-447-cv(CON) (2d Cir. Aug. 15, 2014), *available at* http://www.sifma.org/issues/item.aspx?id=8589934959.

- Section 10(b) will apply to "transactions in securities-based swap agreements where the transactions are domestic and where the defendants are alleged to have sufficiently subjected themselves to the statute." Lower courts will have to sort out what facts will suffice to adequately plead that defendants "subjected themselves" to liability under the U.S. securities laws.

Thus, the implications of the Second Circuit's decision will likely be borne out in the district courts. Interestingly, because the Court of Appeals remanded the case to allow the District Court to entertain a motion to amend the complaints, the inaugural application of the Second Circuit's holding may come sooner than expected.

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If you have any questions, please feel free to contact any of your regular contacts at the firm. You may also contact our partners and counsel listed under "Litigation and Arbitration" located in the "Practices" section of our website at http://www.clearygottlieb.com.

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