SIMPSON THACHER MEMORANDUM

Second Circuit Extends Supreme Court Ruling on Extraterritorial Unavailability of Exchange Act Claims

May 27, 2014

On May 6, 2014, the United States Court of Appeals for the Second Circuit held, in a case of first impression, that the U.S. Supreme Court's 2010 decision in *Morrison* v. *National Australia Bank* precludes claims brought under the Securities Exchange Act of 1934 ("Exchange Act") that arise out of foreign-issued securities purchased on foreign exchanges but cross-listed on a domestic exchange.[1] The landmark *Morrison* decision found that Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder do not provide a cause of action relating to the purchase of foreign-issued securities listed and bought on foreign exchanges.[2] In *City of Pontiac Policemen's and Firemen's Retirement System* v. *UBS AG*, the Second Circuit found *Morrison* to apply to purchases of UBS shares on foreign exchanges, despite the fact that UBS is cross-listed on the New York Stock Exchange.

I. THE SECOND CIRCUIT'S OPINION

A. Extraterritoriality and the Exchange Act

In extending *Morrison*'s reach, the Second Circuit rejected two theories advanced by plaintiffs attempting to sue Swiss-based UBS for alleged violations of the federal securities laws.

1. The "Listing Theory"

Under their "listing theory," the plaintiffs argued that because the shares at issue were cross-listed on a U.S. stock exchange, they fall within the purview of Section 10(b). Despite language in *Morrison* limiting Section 10(b) claims to "transactions in securities listed on domestic exchanges," the Second Circuit found the "listing theory" to be "irreconcilable with *Morrison* read as a whole" – *Morrison* highlighted the fact that the Exchange Act is focused on purchases and sales of securities in the U.S., and thus, the relevant factor is the location of the securities transaction, rather than the location of an exchange on which the security may be dually listed.

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[1] *See City of Pontiac Policemen's and Firemen's Ret. Sys., et al.* v. *UBS AG, et al.*, 2014 WL 1778041, No. 12-4355-cv (2d Cir. May 6, 2014).

[2] *See Morrison, et al.* v. *National Australia Bank Ltd., et al.*, 561 U.S. 247 (2010). According to *Morrison*, "Section 10(b) reaches the use of a manipulative or deceptive device or contrivance only in connection with the purchase or sale of a security listed on an American stock exchange, and the purchase or sale of any other security in the United States." *Id*. at 273.

The Second Circuit concluded that under *Morrison*, Section 10(b) does not apply "to claims by a foreign purchaser of foreign-issued shares on a foreign exchange simply because those shares are also listed on a domestic exchange."[3]

2. Placing a "Buy Order" in the U.S.

In addition to advocating the "listing theory," one of the plaintiffs – a U.S. entity – asserted that its purchase of UBS shares on a foreign exchange constituted a domestic transaction under *Morrison*, because it placed its "buy order" in the U.S. The Second Circuit rejected this argument, as well. The Court referenced its 2012 decision in *Absolute Activist Value Master Fund Ltd.* v. *Ficeto*, which explained that a securities transaction is domestic under *Morrison* "when the parties incur irrevocable liability to carry out the transaction within the United States or when title is passed within the United States."[4] The *City of Pontiac* Court concluded that neither a purchaser's U.S. citizenship or residency, nor the placement of a "buy order" in the U.S. which was later executed on a foreign exchange, is sufficient to establish that the plaintiff incurred irrevocable liability in the U.S. The Second Circuit, thus, affirmed the district court's judgment dismissing the plaintiff's claims to the extent they were based on purchases of foreign shares on foreign exchanges.

B. Dismissal of Claims Against Underwriters

In addition to ruling on the extraterritorial reach of the Exchange Act, the Second Circuit upheld the dismissal of the plaintiffs' claims under Sections 11 and 12(a) of the Securities Act of 1933 ("Securities Act") against UBS and a group of underwriters.[5] The plaintiffs had claimed that the offering materials at issue were (1) materially false in that they stated "that UBS held its employees to the highest ethical standards and complied with all applicable laws," and (2) materially incomplete in that they disclosed a Department of Justice investigation but concealed both that the cross-border activities under investigation were ongoing and "the magnitude of UBS's exposure to liability and reputational damage."[6] The Court, however, found these alleged false or misleading statements to be inactionable because, among other things, statements about compliance, reputation, and integrity are inactionable "puffery," and because UBS complied with its disclosure obligations by disclosing its involvement in legal proceedings and government investigations and indicating that its involvement could expose the company

[3] *City of Pontiac*, 2014 WL 1778041, at *4.

[4] *Id.* (citations omitted).

[5] The underwriters were represented by Simpson Thacher & Bartlett LLP.

[6] *City of Pontiac*, 2014 WL 1778041, at *4.

to substantial monetary damages and legal defense costs, as well as injunctive relief, criminal and civil penalties, and potential regulatory restrictions.[7]

II. SIGNIFICANCE OF THE DECISION

The Second Circuit's decision limits the ability of plaintiffs to make an end-run around the Supreme Court's *Morrison* ruling simply by claiming that the foreign securities were cross-listed on a U.S. exchange or that the foreign securities were purchased by placing a "buy order" in the U.S. The decision reinforces that securities fraud actions under the Exchange Act are not available to those who purchase foreign-issued securities on a foreign exchange.

The *City of Pontiac* decision also confirms that there is no cause of action under the Securities Act (against issuers or underwriters) for statements that amount to puffery or for failing to confess to the alleged wrongdoing at the center of a government investigation.

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If you have any questions or would like additional information, please do not hesitate to contact Craig S. Waldman at (212) 455-2881 or cwaldman@stblaw.com, Yafit Cohn at (212) 455-3815 or yafit.cohn@stblaw.com, or any other member of the Firm's Securities Litigation Practice or the Firm's Public Company Advisory Practice.

This memorandum is for general information purposes and should not be regarded as legal advice. Please contact your relationship partner if we can be of assistance regarding these important developments. The names and office locations of all of our partners, as well as our recent memoranda, can be obtained from our website, www.simpsonthacher.com.

[7] The Second Circuit also held that the plaintiffs' various claims against UBS under Section 10(b) of the Exchange Act were properly dismissed for failure to plead an actionable misstatement, materiality, or a strong inference of scienter.

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