07-0583-cv

United States Court of Appeals

FOR THE SECOND CIRCUIT

ROBERT MORRISON, individually and on behalf of all others similarly situated, RUSSELL LESLIE OWEN, BRIAN SILVERLOCK, and GERALDINE SILVERLOCK,

Plaintiffs-Appellants,

MARIA KENNEDY, HARVARD B. KOLM and NORMAN HAUGE,

Plaintiffs,

—against—

NATIONAL AUSTRALIA BANK LIMITED, HOMESIDE LENDING INC., FRANK CICUTTO, HUGH HARRIS, KEVIN RACE and W. BLAKE WILSON,

Defendants-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

SUPPLEMENTAL BRIEF FOR DEFENDANTS-APPELLEES NATIONAL AUSTRALIA BANK LIMITED AND FRANK CICUTTO IN RESPONSE TO THE BRIEF *AMICUS CURIAE* OF THE SECURITIES AND EXCHANGE COMMISSION

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The SEC asks this Court to overrule, *sub silentio*, the case law in this Circuit applying the conduct test. In lieu of the "directly cause" and "merely preparatory" language of *Bersch*, the agency urges that this Court apply a new, more jurisdictionally expansive conduct test that looks to whether "the conduct in the United States is material to the fraud's success and forms a substantial component of the fraudulent scheme." SEC Br. 2, 22. This new test, the SEC claims, would "bring needed clarity and would shift the inquiry from a case-by-case analysis that turns on 'very fine distinctions.' " *Id.* at 22. But in almost the same breath, the SEC says that its new standard would allow courts the "flexibility" to make *precisely* the sort of fine, case-by-case distinctions that it claims to eschew—"flexibility for courts to address the 'numerous combinations and permutations of, for example, the parties and the types, places, timing and effects of relevant conduct.' " *Id.* at 26 (citation omitted).

The SEC's self-contradictory analysis is wrong, and its proposed new test should be rejected. Adoption of the new test would contravene the Supreme Court's extensive case law on extraterritoriality and prescriptive comity (points 1 and 2 below); it would completely confuse, and certainly not clarify, the law in this Circuit (point 3); and it would contravene the Supreme Court's decision in *Stoneridge* v. *Scientific-Atlanta* (point 4).

1. If this Court accepts the SEC's conclusion that "the Second Circuit's decisions do not provide a clear answer to the correct resolution of the jurisdictional issue in this case," SEC Br. 21, then the judgment below should be affirmed. The Supreme Court's cases addressing extraterritoriality and prescriptive comity make clear that if the conduct test were *itself* a statutory provision, and it were found to be ambiguous in its application, the statute must be construed not to apply extraterritorially. The Supreme Court "look[s] to see whether 'language in the [relevant Act] gives any indication of a congressional purpose to extend its coverage beyond places over which the United States has sovereignty or has some measure of legislative control.' " *EEOC* v. *Arabian Am. Oil Co.*, 499 U.S. 244, 248 (1991) (quoting *Foley Bros.* v. *Filardo*, 336 U.S. 281, 285 (1949)). "Therefore, unless there is the 'affirmative intention of the Congress clearly expressed,' we must presume it 'is primarily concerned with domestic conditions,' " and a statute will " 'apply only within the territorial jurisdiction of the United States.' " *Id.* (quoting *Benz* v. *Compania Naviera Hidalgo, S.A.*, 353 U.S. 138, 147 (1957), and *Foley Bros.*, 336 U.S. at 285)). And even when a statute " 'specifically addresses [an] issue of extraterritorial application,' " the presumption against extraterritoriality "remains instructive in determining the *extent* of the statutory exception." *Microsoft Corp.* v. *AT&T Corp.*, 127 S. Ct. 1746, 1758 (2007) (emphasis in original; quoting *Smith* v. *United States*, 507 U.S. 197, 204 (1993)). So if a statute leaves any doubt as to whether Congress intended it to apply extraterritorially in a given case, the statute must be construed *not* to so apply.

But there is even more reason to reach such a conclusion here. The conduct test is not a statute; it is a

judicially-created addendum to a statute. And as this Court has repeatedly acknowledged, it is a judicial creation that has no evidence of congressional intent to support it. "We freely acknowledge that if we were asked to point to language in the statutes, or even in the legislative history, that compelled these conclusions, we would be unable to respond." *Bersch* v. *Drexel Firestone, Inc.*, 519 F.2d 974, 993 (2d Cir. 1975); *accord*, *e.g.*, *Alfadda* v. *Fenn*, 935 F.2d 475, 478 (2d Cir. 1991) (statute is "silent as to its extraterritorial application"). Indeed, to the extent there is any evidence of legislative intent on the point, it indicates that Congress "chose to protect *only* those investors whose trades occur inside the United States." Margaret V. Sachs, *The International Reach of 10b-5: The Myth of Congressional Silence*, 28 COLUM. J. TRANSNAT'L L. 677, 681 (1990) (emphasis added).

Not only that, the underlying private right of action to which the conduct test attaches is itself a "judicial construct that Congress did not enact in the text of the relevant statutes." *Stoneridge Inv. Partners, LLC* v. *Scientific-Atlanta, Inc.*, 128 S. Ct. 761, 772 (2008). After the Section 10(b) private right was recognized, of course, the Supreme Court "swor[e] off the habit of venturing beyond Congress's intent," adhering instead to the view that " '[r]aising up causes of action where a statute has not created them may be a proper function for common-law courts, but not for federal tribunals' "; today, when "a cause of action does not exist" under a statute, "courts may not create one, no matter how desirable that might be as a policy matter, or how compatible with the statute." *Alexander* v. *Sandoval*, 523 U.S. 275, 287 (2001) (citation omitted). By the same token, in interpreting the existing implied right under Section 10(b),

the Supreme Court has taken a "careful approach . . . before proceeding without congressional direction," because extending implied rights " 'runs contrary to the established principle that "[t]he jurisdiction of the federal courts is carefully guarded against expansion by judicial interpretation." ' " *Stoneridge*, 128 S. Ct. at 772 (citations omitted). The bottom line: "The decision to extend the cause of action is for Congress, not for us. Though it remains the law, the § 10(b) private right should not be extended beyond its present boundaries." *Id.* at 773.

In short, if the Court concludes, as the SEC suggests, that the existing conduct test does not yield a clear answer here, that would be reason enough to affirm.

2. The SEC's attempt to distinguish Empagran *flies in the face of over 200 years of Supreme Court precedent.* The SEC summarily dismisses the Supreme Court's case law on extraterritoriality and prescriptive comity by observing that the leading case, *F. Hoffman-La Roche Ltd.* v. *Empagran S.A.*, 542 U.S. 155 (2004), is an antitrust case, and by suggesting that historically the antitrust laws have raised "more serious" comity concerns than the securities laws. SEC Br. 28. Yet the SEC acknowledges, as it must, that "F-cubed" securities class actions like this one "have become more prevalent in recent years." *Id.* at 5, 29 n.14.[1] Massive fraud-on-the-market securities class suits like these, seeking billions of dollars, raise significant comity concerns, just as big

[1] *See also* Andrew Longstreth, *Coming to America*, AM. LAW, Nov. 2006, *available at* 11/2006 Am. Law. S53 (Westlaw); Mary Jacoby, *For the Tort Bar, A New Client Base: European Investors*, WALL ST. J., Sept. 2, 2005, at A1.

treble-damages antitrust actions do. As one scholar recently noted, contrary to the rationale of the conduct test,

> other countries may not view the United States as a "good neighbor" when a billion-dollar class action settlement threatens the solvency of one of their major corporations. Indeed, the courts of the Netherlands have recently strained to accommodate their first ever "settlement class" in the case of Royal Dutch/Shell, in part to avoid a world-wide class being certified . . . in New Jersey [against the Netherlands' largest corporation].

John C. Coffee, Jr., *Securities Policeman to the World? The Cost of Global Class Actions*, N.Y.L.J., Sept. 18, 2008, at 5, 6.

Contrary to the SEC's contention, moreover, the Supreme Court has made clear that comity concerns are not limited to antitrust. For over two hundred years, the Court has applied the presumption against extraterritoriality to federal statutes addressing a variety of subjects, such as admiralty, labor regulation, civil rights, torts, sovereign immunity, immigration, and criminal law.[2] And most recently, in its 7-1 decision in *Microsoft*

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[2] *See, e.g., Murray* v. *Schooner Charming Betsy*, 6 U.S. (2 Cranch) 64, 118 (1804) (libel of vessel under law banning trade with France); *Sandberg* v. *McDonald*, 248 U.S. 185, 195-96 (1918) (Seaman's Act of 1915); *Foley Bros.* v. *Filardo*, 336 U.S. at 285 (Eight Hour Law, regulating workdays on government construction contracts); *Lauritzen* v. *Larsen*, 345 U.S. 571, 578 (1953) (Jones Act); *Benz* v. *Compania Naviera Hidalgo*, 353 U.S. at 147 (Labor Management Relations Act of 1947); *McCulloch*

Corp. v. *AT&T Corp.*, 127 S. Ct. 1746, 1758-59 (2007), it applied this "principle of general application" to the field of patents, *id*. at 1758. The principle applies "particularly in commercial matters," as Justice Ginsburg, the author of the Court's opinion in *Microsoft*, made clear at last year's Second Circuit Judicial Conference:

> What was key to our decision in that case was the presumption that United States law, including patent law, governs domestically, but does not hold sway beyond our nation's borders, particularly in commercial matters. . . . We were well aware that, in many nations, there are different views of what is patentable than the ones prevailing in the United States.

Ruth Bader Ginsburg, Remarks at the Second Circuit Judicial Conference Reviewing the Supreme Court's 2006 Term (June 9, 2007).[3]

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v. *Sociedad Nacional de Marineros de Honduras*, 372 U.S. 10, 19-20 (1963) (National Labor Relations Act); *Argentine Republic* v. *Amerada Hess Shipping Corp.*, 488 U.S. 428, 440-41 (1989) (Foreign Sovereign Immunities Act of 1976); *EEOC* v. *Arabian Am. Oil Co.*, 499 U.S. at 248 (Title VII of the Civil Rights Act of 1964). *Smith* v. *United States*, 507 U.S. 197, 204 & n.5 (1993) (Federal Tort Claims Act); *Sale* v. *Haitian Ctrs. Council, Inc.*, 509 U.S. 155, 173-74 (1993) (Immigration and Nationality Act of 1952); *Small* v. *United States*, 544 U.S. 385, 388 (2005) (criminal statute regulating firearms possession).

[3] Audio recording available at the website of the Oyez Project, http://www.oyez.org/justices/ruth_bader_ginsburg/2007_judicial_conference/ (quoted portion begins approximately 14 minutes, 30 seconds into the recording).

The SEC's proposed test cannot be reconciled with *Microsoft*. The Supreme Court there construed American patent law not to apply even though, to borrow from the SEC's proposed standard here, "the conduct in the United States" in that case was unquestionably "material" to the alleged infringement and "form[ed] a substantial component of the [infringement] scheme." SEC Br. 2, 22. The plaintiff was American, the defendant was American, and the invention at issue—AT&T's voice-recognition technology, incorporated into Microsoft Windows—was patented in America and was improperly incorporated into Windows in America. 127 S. Ct. at 1752-53. Master copies of Windows were shipped from the United States to places abroad, where they were replicated and installed in personal computers. *Id.* at 1753. Yet despite all the domestic conduct, the Supreme Court held that "[t]he remedy . . . lies in obtaining and enforcing foreign patents." Remarks of Justice Ginsburg, *supra*; *accord Microsoft*, 127 S. Ct. at 1759. Any change in the law, the Court added, "should be made after focused legislative consideration, and not by the Judiciary forecasting Congress' likely disposition." 127 S. Ct. at 1760.

So, too, in this case: the fact that—analogously to the invention in *Microsoft*—false financial information was claimed to have originated in the United States, then incorporated into materials that were prepared and disseminated abroad, cannot suffice to support the application of an American statute—"unless there is the 'affirmative intention of the Congress clearly expressed,' " *EEOC* v. *Arabian Am. Oil Co.*, 499 U.S. at 248 (quoting *Benz* v. *Compania Naviera Hidalgo*, 353 U.S. at 147), which here there surely is not. The remedy for foreign investors who purchase foreign securities of

a foreign issuer on a foreign exchange on the basis of disclosures prepared and disseminated in a foreign land should be under foreign law in that foreign land.

3. The SEC's proposed new standard would foster confusion, not clarity. As for the conduct test as it stands, the SEC not only misapprehends the problem, but offers a solution that would do the opposite of solving it. To begin with, the SEC's assertion that this Court has "developed the law on a case-by-case basis without explicitly articulating the generally applicable standard" for the conduct test (SEC Br. 10) is demonstrably off the mark. Repeating language that originated in *Bersch*, this Court has consistently set forth the generally applicable standard, which is that

> the test is met whenever (1) "the defendant's activities in the United States were more than 'merely preparatory' to a securities fraud conducted elsewhere" and (2) the "activities or culpable failures to act within the United States 'directly caused' the claimed losses."

SEC v. *Berger*, 322 F.3d 187, 193 (2d Cir. 2003) (quoting *Itoba* v. *Lep Group PLC*, 54 F.3d 118, 122 (2d Cir. 2003) (quoting *Bersch* v. *Drexel Firestone, Inc.*, 519 F.2d 974, 987 (2d Cir. 1975), and *Alfadda* v. *Fenn*, 935 F.2d at 478); *accord*, *e.g.*, *Europe & Overseas Commodity Traders, S.A.* v. *Banque Paribas London*, 147 F.3d 118, 128-29 (2d Cir. 1998); *North South Fin. Corp.* v. *Al-Turki*, 100 F.3d 1046, 1051 (2d Cir. 1996); *Psimenos* v. *E.F. Hutton & Co.*, 722 F.2d 1041, 1045-46 (2d Cir. 1983).

The problem is not the absence of a "generally applicable standard"; the problem comes in applying the gen-

erally applicable standard to widely varying factual patterns. And so the SEC is wrong to suggest that its new proposed generally applicable standard would "bring needed clarity" to the law. SEC Br. 22. Judges and lawyers will find that determining what is "material" or "substantial" in cases tomorrow will be no easier than identifying "direct" causes and "preparatory activities" today. *Id*. at 24, 25. Indeed, in a glaring inconsistency, the SEC actually praises its proposed new standard *precisely because* it would give courts the "flexibility . . . to address the 'numerous combinations and permutations of, for example, the parties and the types, places, timing and effects of relevant conduct.' " *Id*. at 26 (citation omitted). In other words, under the SEC's test, courts would *still* engage in "case-by-case analysis that turns on 'very fine distinctions.' " *Id*. at 22. But isn't that the problem the SEC identifies in the first place?

The SEC's solution actually would make the problem it identifies worse, because it asks the Court to engage in a not-so-candid sleight-of-hand. The SEC would have this Court substitute the new standard while claiming to do nothing more than "build[ ] on the existing approach of this Circuit." *Id*. at 23.[4] So district judges and lawyers

[4] The SEC justifies this assertion by pointing to the use of the words "material" and "substantial" in both *Psimenos* and *Berger*. SEC Br. at 23. But as the passage quoted from *Berger* in the text above makes clear, *Berger* adheres to *Bersch*'s direct-causation standard. So does *Psimenos*:

> *Bersch* reveals that . . . we entertain suits by aliens only where conduct material *to the completion* of the fraud occurred in the United States. *Mere preparatory* activities, and conduct far removed from *the*

would know something was different in the law, but perhaps not exactly what, because the old cases would still officially be good law. At the same time, though, in practical effect, *Bersch* would be overruled. For the SEC interprets its new conduct test to be met whenever "the domestic conduct was an integral link in the chain of events leading to the overseas investors' losses," and whenever "[w]ithout th[e] domestic misconduct, there would have been no fraudulent release of information in [the foreign country] nor a resulting inflation of [the foreign company's] stock" on a foreign exchange. *Id.* at 30. Yet that is plainly a but-for causation standard—*exactly* the holding that this Court *reversed* in *Bersch*. *See Bersch* v. *Drexel Firestone, Inc.*, 389 F. Supp. 446, 457 (S.D.N.Y. 1974) (United States activities were "conduct constituting an *essential link*" in fraudulent scheme; emphasis added), *rev'd*, 519 F.2d 974 (2d Cir. 1975).

To abandon an existing body of precedent in order to substitute one arguably opaque standard with another, and to do so without specifying exactly what was abandoned, would only serve to flummox the bench and bar. If the Court wishes to clarify the law, following the SEC's approach is surely *not* the way to go.

4. The SEC's proposed new standard cannot be reconciled with the Supreme Court's decision in Stoneridge. Finally, application of the SEC's proposed but-for causation test would mean that defendants could be held

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> *consummation* of the fraud will not suffice . . . . Only where conduct 'within the United States *directly caused*' the loss will a district court have jurisdiction.

Psimenos, 722 F.2d at 1046 (emphasis added; quoting *Bersch*, 519 F.2d at 993).

liable to foreign plaintiffs for foreign securities transactions *even when the domestic conduct involved would be too causationally remote to support liability* under the Supreme Court's decision in *Stoneridge.*

Quite the opposite was true under different substantive legal framework that existed when *Bersch* was decided in 1975. *Bersch* recognized the need to have a standard of causation that was *stricter* on the question of extraterritoriality than ordinarily existed for the imposition of liability. The claims against the American defendants there —underwriters, accountants, lawyers who assisted in the IOS offerings—were *aiding-and-abetting* claims of the sort that were permissible until the Supreme Court's decision 19 years later in *Central Bank of Denver, N.A.* v. *First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994). Yet even though aiding-and-abetting claims were then allowed, the Court in *Bersch* held that these defendants were *not* amenable to suit for purchases made by foreign plaintiffs abroad, and that, indeed, the transactions were beyond the reach of the federal securities laws entirely.

Today, in contrast, not only are aiding and abetting claims barred under *Central Bank*, but " 'scheme liability' " claims of the sort that the Australian plaintiffs assert against the American defendants here are explicitly barred by *Stoneridge,* 128 S. Ct. at 770. The Supreme Court has now expressly *rejected* the contention that, for purposes of the private right under Section 10(b), "investors rely not only upon the public statements relating to a security but also upon the transactions those statements reflect." *Id.* And so it does not state a claim to allege that defendants "engaged in conduct with the purpose and effect of creating a false

appearance of material fact to further a scheme to misrepresent [the issuer's] revenue," or that "the financial statement [the issuer] released to the public was a natural and expected consequence of the [defendants'] deceptive acts." *Id.*; *compare id. with* SEC Br. 30 ("The information that made the statements in Australia false was generated in the United States with the expectation that it would be distributed to foreign investors."). Put another way, "deceptive acts [that] were not communicated to the public" do not suffice to "show reliance . . . except in an indirect chain that we find too remote for liability." *Stoneridge*, 128 S. Ct. at 769; *accord Pugh* v. *Tribune Co.*, 521 F.3d 686, 696-97 (7th Cir. 2008).

In short, now that the Supreme Court has *tightened* the substantive causation requirement for liability under the implied right of action under Section 10(b), it would make *no* sense to *loosen* the causation standard for imposing liability for foreign transactions.[5] Under

[5] It would be no answer to say that the conduct test involves the question of "jurisdiction," whereas the *Stoneridge* question was substantive. The use of the phrase "subject matter jurisdiction" here is, in reality, a misnomer. *See*, *e.g.*, *Arbaugh* v. *Y&H Corp.*, 546 U.S. 500, 516 (2006) (issues are not jurisdictional unless Congress says so); *AVC Nederland B.V.* v. *Atrium Inv. P'ship*, 740 F.2d 148, 153 (2d Cir. 1984) (noting that treatment of conduct test as one of subject matter jurisdiction may be incorrect). In *Empagran*, the Supreme Court treated the extraterritoriality question as a merits question, even though the Court of Appeals treated it as one of subject matter jurisdiction. *Compare*, *e.g.*, *Empagran*, 542 U.S. at 158-59, 163-73 (no reference to "subject matter

Stoneridge, the conduct that allegedly constitutes actionable *securities* fraud in this case occurred *entirely* in Australia. The remedy must lie there as well.

CONCLUSION

It is respectfully submitted that the SEC's proposed new test should be rejected, and the judgment of the district court should be affirmed.

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jurisdiction"), *with Empagran S.A.* v. *F. Hoffmann-LaRoche, Ltd.*, 315 F.3d 338, 341 (D.C. Cir. 2003) ("we hold that subject matter jurisdiction is proper"), *rev'd*, 542 U.S. 155 (2004).

CERTIFICATE OF COMPLIANCE

1. This supplemental brief contains 3,261 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii). A motion for leave to file this supplemental brief is being filed with the Court.

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) as modified for printed briefs in pamphlet format by Local Rule 32(a)(2), and complies with the type style requirements of Fed. R. App. P. 32(a)(6), because it has been prepared in a proportionally spaced typeface using QuarkXPress 5.1 in 12-point Times font.

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