Securities Regulation Daily Wrap Up,TOP STORY—2d Cir: Morrison bar applies to cross-listed securities,(May 6, 2014)

By Matthew Garza, J.D.

In a matter of first impression, the Second Circuit U.S. Court of Appeals decided that the bright-line transactional test established in *Morrison v National Australia Bank* also applies to securities purchased on a foreign exchange even if the securities are cross-listed on a U.S. exchange. The court said that *Morrison* emphasized that the Exchange Act is focused on purchases and sales of securities in the U.S., so the location of the transaction, and not the location of the exchange, is the key question. A buy order for foreign-issued securities placed inside the U.S. and executed on a foreign exchange was also found to be insufficient to incur "irrevocable liability" in the U.S., and therefore could not escape the *Morrison* bar on extraterritorial application of U.S. securities laws. (*City of Pontiac Policemen's and Firemen's Retirement System v. UBS AG*, May 6, 2014, Cabranes, J.).

Fraud claims. The class consisted of institutional investors that purchased UBS shares between August 13, 2003 and February 23, 2009. The investors alleged that the bank made fraudulent statements regarding its residential mortgage-backed securities (RMBS) portfolio, and compliance with U.S. tax and securities laws by its Swiss-based global cross-border private banking business. UBS accumulated and overvalued $100 billion in RMBS without disclosing it to shareholders, investors claimed, and the RMBS holdings contravened the bank's risk management policies.

The class alleged that the bank also made materially misleading statements about a tax fraud scheme in which members of the bank's Wealth Management International & Switzerland division traveled in and out of the U.S. to illegally advise affluent clients on the purchase of investments. In a February 19, 2009 deferred prosecution agreement with the Department of Justice, UBS admitted that it participated in a conspiracy to defraud the IRS and paid a $780 million fine.

Judge Sullivan of the Southern District of New York first dismissed claims brought by plaintiffs who purchased UBS shares of foreign exchanges in September 2011, and a year later dismissed the remaining claims because of pleading failures.

Foreign cubed. The court first addressing claims brought by foreign institutional investors who purchased shares on a foreign exchange, referred to as "foreign-cubed" claims. These claims involve a foreign plaintiff suing a foreign issuer in the U.S. for violations of U.S. securities laws based on transactions in foreign countries.

The court rejected the investors' argument that the *Morrison* bar did not apply because it is limited to claims arising out of securities "*[not] listed* on a domestic exchange." Under this

"listing theory," the investors asserted, the fact that the UBS shares were also cross-listed on the New York Stock Exchange brings them within the purview of U.S. securities laws. The court wrote that if taken in isolation, the language of *Morrison* appears to support this argument, but the listing theory was irreconcilable with *Morrison* read as a whole.

"Morrison's emphasis on 'transactions in securities listed on domestic exchanges,' makes clear that the focus of both prongs was domestic transactions of any kind, with the domestic listing acting as a proxy for a domestic transaction," wrote Judge Cabranes. The Supreme Court rejected the idea that transactions on a foreign exchange implicate U.S. national interests, and the fact that the securities at issue in *Morrison* were also available on the NYSE as ADRs did not alter the Court's analysis. "Most telling," said the court, was the Supreme Court's clear rejection of the Second Circuit's "conduct and effects" test, which held that the Exchange Act applies to transactions regarding stocks trading in the U.S. which are effected outside the U.S.

Foreign squared. The court next turned to claims asserted by a U.S. entity that purchased UBS shares on a foreign exchange after placing a buy order in the U.S. that was later executed on a Swiss exchange. The court held in *Absolute Activist Value Master Fund Ltd. v. Ficeto* that a securities transaction is domestic if the parties incur irrevocable liability to carry out the transaction within the U.S. This raised another issue—whether the mere placement of a buy order in the United States for the purchase of foreign securities on a foreign exchange is sufficient to allege that a purchaser incurred irrevocable liability in the United States. The court ruled that it did not, saying that the nationality of the entity was a non-factor, as was the fact that the entity placed the order in the U.S.

Securities Act claims. The court went on to uphold the Southern District's dismissal of allegations that UBS's offering materials were materially misleading because they did not disclose the DOJ investigation and falsely stated that UBS's wealth management division did not provide services to U.S. clients. Allegations regarding statements made by UBS that its employees were held to high ethical standards were properly dismissed because the statements were immaterial puffery, said the court. The bank did disclose the existence of an investigation, the court pointed out, but it was also not required to disclose that it was involved in a tax evasion scheme. Companies have no duty to disclose "uncharged, unadjudicated" wrongdoing, the court said.

Dismissal of Exchange Act claims relating to the level of risk in the bank's RMBS portfolio was also proper because the investors did not sufficiently allege that UBS's representations regarding asset concentrations were materially misleading or that the bank was consciously reckless in making the representations. Allegations of fraud stemming from the bank's valuation of its RMBS assets were also insufficient.

The case is No. 12-4355-cv.

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