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Update: *Tourre* Extends SEC's Reach For Foreign Transactions Involving Domestic Offerings

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A recent decision by Judge Katherine Forrest of the U.S. District Court for the Southern District of New York clarified the scope of the Securities and Exchange Commission's (the ''SEC'') ability to pursue fraud charges in foreign securities transactions involving domestic offerings.[1] The SEC alleges that former Goldman Sachs & Co. Vice President Fabrice Tourre failed to disclose that hedge fund manager John Paulson helped to select, and then shorted, the portfolio of securities underlying the ABACUS 2007-AC1 synthetic collateralized debt obligation at issue in that matter.[2] Tourre moved for summary judgment, arguing that he could not be held liable for offerings in connection with foreign transactions under the Supreme Court's landmark 2010 decision, *Morrison v. National Australia Bank Ltd.*[3]

[1] *SEC v. Tourre*, No. 10 Civ. 3229 (KBF), 2013 BL 145867 (S.D.N.Y. June 4, 2013).

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Morrison v. National Australia Bank Ltd.

The Court's decision in *Morrison* upset four decades of circuit court precedent by overruling the U.S. Court of Appeals for the Second Circuit's long-standing ''conduct and effects'' test for determining whether fraud suits may be brought under the federal securities laws with respect to securities transactions with a foreign component. Beginning its analysis with the canon that legislation is presumed not to have extraterritorial effect unless ''contrary intent appears'' in the statute,[4] the Court set forth a new bright-line ''transactional'' test which limits the reach of Section 10(b) of the Securities Exchange Act of 1934 (the ''Exchange Act'') and Rule 10b-5 thereunder to transactions involving (1) ''the purchase or sale of a security listed on an American stock exchange'' or (2) ''the purchase or sale of any other security in the United States.''[5] Moreover, the Court clarified that the circuit court's analysis of the question as one of subject-matter jurisdiction was misplaced;

[2] Goldman Sachs settled charges brought against it by the SEC in connection with the ABACUS transaction in 2010 for $550 million.

[3] 130 S. Ct. 2869 (2010).

[4] *Morrison*, 130 S. Ct. at 2877 (quoting *EEOC v. Arabian American Oil Co.*, 499 U.S. 244 (1991)).

[5] *Id.* at 2888; *see id.*at 2894 n.11 (Stevens, J., concurring) (quoting *Morrison v. Nat'l Austl. Bank Ltd.*, 547 F.3d 167 , 172 (2d Cir. 2008) (involving a so-called ''foreign-cubed'' transaction, in which ''(1) foreign plaintiffs su[ed] (2) a foreign issuer in an American court for violations of American securities laws based on securities transactions in (3) foreign countries'').

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rather, ''to ask what conduct § 10(b) reaches is to ask what conduct § 10(b) prohibits, which is a merits question.''[6]

Subsequent district court cases have held that *Morrison* applies to cases brought under Section 17(a) of the Securities Act of 1933 (the ''Securities Act'') as well.[7] More recently—in the first circuit court case to consider the question—the Second Circuit held that a securities transaction is domestic for the purposes of the second-prong of *Morrison* when irrevocable liability was incurred or title was transferred within the United States.[8]

SEC v. Tourre

Recently, in *SEC v. Tourre*, Judge Forrest—in a question of first impression—considered the effect of the Supreme Court's holding in *Morrison* on Section 17(a) cases brought by the SEC in connection with the fraudulent *offering*, as opposed to sale, of securities. Section 17(a) provides, in pertinent part:

> It shall be unlawful for any person in the *offer* or sale of any securities . . . directly or indirectly —
>
> (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or
>
> (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.[9]

Tourre moved for summary judgment on the SEC's Section 17(a) claims related to offers made to two foreign investors, IKB Deutsche Industriebank AG (''IKB'') and ABN AMRO Bank N.V. (''ABN''), arguing that the offers were not ''domestic'' under *Morrison*.[10]

As the court framed the analysis, the primary question of law that the parties disputed was ''what it means for fraud made 'in the offer' of securities to be domestic for purposes of Section 17(a) and *Morrison*.''[11] Under Tourre's reading, ''if an offer leads to a consummated sale, only the sale is actionable. [Thus,] if the sale is not domestic, neither the sale nor the offer is actionable under *Morrison*.''[12] Similarly, an offer is actionable under Tourre's reading ''if and only if it is both domestic and ultimately unconsummated.''[13] Because the sales to IKB and ABN were consummated outside the United States, Tourre urged, the offers made to IKB and ABN were not actionable under *Morrison*.

In rejecting Tourre's motion, Judge Forrest distinguished Exchange Act Section 10(b), which prohibits fraud in connection with the ''purchase or sale of any security,'' from Securities Act Section 17(a), which concerns the ''*offer* or sale of any securities.''[14] The court then turned to the definition of ''offer'' in Section 2(a)(3) of the Securities Act, which ''include[s] every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security for value.''[15] Viewing Sections 17(a) and 2(a)(3) in conjunction, the court held:

> [L]ike Section 10(b), Section 17(a) prohibits only a narrow subset of fraudulent activity. Unlike Section 10(b), however, the prohibited conduct is circumscribed by its connection with ''the offer or sale of any securities,'' rather than with the ''purchase or sale of any security.''
>
> That distinction is key. Section 17(a)'s proscription extends beyond consummated transactions. Because Section 17(a) is not exclusively concerned with fraudulent conduct in connection with a transaction in securities, but rather is concerned with such conduct in either the offer or the sale of securities, the requirement of domestic conduct under Section 17(a) must be extended accordingly. This means that a domestic offer may be actionable regardless of whether it results in a sale. *Morrison*'s requirement of domestic conduct is necessarily applied individually and independently to each type of potential violation of Section 17(a).[16]

Rejecting Tourre's invitation to ''read a silent 'unconsummated' before the word 'offer' in Section 17(a),'' the court held that ''Section 17(a) does not distinguish between consummated and unconsummated offers, and the Court can find no other statutory basis from which to make that distinction.''[17] Given this clear distinction in the statutory language, the court ruled that a domestic offer may be actionable under Section 17(a) regardless of whether it results in a sale, concluding:

> The Court's interpretation of Section 17(a) is dictated by common sense. It defies reason to adopt a construction of Section 17(a) that could permit the SEC to prove that each and every element of its claim occurred—and occurred in the United States—only to require dismissal because a separate ''sale'' took place abroad. The presumption against extraterritoriality does not require such a result; *Morrison*'s holding does not require such a result . . . .''[18]

The court then turned to defining what it means for an offer to be domestic. The court characterized Tourre's argument as requiring that ''an offer should be

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[6] *Morrison*, 130 S. Ct. at 2877 (holding that the District Court unequivocally had jurisdiction ''to adjudicate the question whether § 10(b) applie[d] to [the defendant's] conduct'' under Section 27 of the Exchange Act).

[7] *See, e.g.*, *SEC v. Goldman Sachs & Co.*, 790 F. Supp. 2d 147, 164 (S.D.N.Y. June 10, 2011) (''*Morrison* applies to Section 17(a) of the Securities Act.''); *cf. In re Royal Bank of Scotland Grp. PLC Sec. Litig.*, 765 F. Supp. 2d 327, 338 n.11 (S.D.N.Y. 2011) (''[T]he *Morrison* Court clearly expressed that the territorial reach of the Exchange Act and Securities Act involves the '*same* focus on domestic transactions.' '' (quoting *Morrison*, 130 S. Ct. at 2885) (emphasis in *Royal Bank of Scotland*)).

[8] *Absolute Activist Value Master Fund Ltd. v. Ficeto*, 677 F.3d 60 (2d Cir. 2012).

[9] 15 U.S.C. § 77q(a) (emphasis added).

[10] Tourre also moved for summary judgment on Section 17(a) claims related to offers made to unspecified domestic investors, urging that the record did not substantiate that he had made any such offers. Focusing on the ''directly or indirectly'' language in the statute, the Court held that defendants need not personally offer securities to be liable; rather, they need only have acted as a ''necessary participant'' or a '' 'substantial factor' in the relevant offer or sale of securities.'' *Tourre*, U.S. Dist. LEXIS 78297, at *36-37 (quoting *SEC v. Hoschuth*, 694 F.2d 130, 139 (7th Cir. 1982)).

[11] *Tourre*, 2013 BL 145867, at *5.

[12] *Id.* at *6-7.

[13] *Id.* at *7.

[14] *Id.* at *6 (emphasis added). *Compare* Exchange Act § 10(b), 15 U.S.C. § 78j(b), *with* Securities Act § 17(a), 15 U.S.C. § 77q(a).

[15] 15 U.S.C. § 77b(a)(3).

[16] *Tourre*, 2013 BL 145867, at *6 (internal citations omitted).

[17] *Id.* at *8.

[18] *Id.* at *8–9.

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considered domestic only if it is made to a person physically located in the United States.''[19] Focusing once again on the statutory language, the court—in rejecting Tourre's argument—noted that ''[a]n 'offer' is just that—the act of making an offer, as defined by Section 2(a)(3). The statute is not worded as 'to whom' an offer is made, or some other construct;''[20] rather, the ''focus of the term 'offer,' both in the context of Section 17(a) and as it is defined [in Section 2(a)(3)], is on the person offering or attempting to offer securities, not on the recipient of the offer.''[21]

Following that line of reasoning, the court held that ''[a]n offer is domestic if it is made in the United States.''[22] Thus, to satisfy *Morrison*, the SEC need only prove that a defendant ''engaged in fraudulent conduct in connection with'' an offer and that the ''offeror was in the United States at the time he or she made the relevant offer.''[23] On that basis, the court found that the SEC satisfied its burden in opposing Tourre's summary judgment motion by ''cit[ing] to record evidence that would allow a reasonable jury to find that Tourre worked in New York at all relevant times'' and that he had ''e-mailed and called both IKB and ABN to discuss possible transactions involving [the ABACUS CDO].''[24]

Tourre's trial began July 15.

Other Open Questions Post-Morrison

Applicability of *Morrison* to Criminal Prosecutions

The status of *Morrison* with respect to criminal prosecutions under the federal securities laws remains an actively debated question. The Justice Department has argued strenuously that *Morrison* applies strictly to civil litigation, not to criminal prosecutions. The Second Circuit is presently grappling with this question in two pending appeals, as is at least one lower court.

In *United States v. Vilar*,[25] defendants have appealed their securities fraud convictions partly on *Morrison* grounds, arguing that the transactions underlying those convictions occurred offshore and were therefore beyond the reach of U.S. securities laws.[26] Relying on *United States v. Bowman*,[27] the Government counters that the Supreme Court did not intend its decision in *Morrison* to ''limit the ability of the United States to bring criminal securities fraud prosecutions involving overseas transactions.''[28] Oral argument was held on August 21, 2012.

Similarly, in *United States v. Mandell*,[29] defendants have appealed their securities fraud convictions under *Morrison*. Again, the Government argues that the presumption against extraterritoriality does not apply to criminal statutes, asking the court to conclude that the exact same words can have differing meanings depending on whether they are being applied in a criminal case or a civil enforcement action.[30] Siding with the defendants-appellants, the New York City Bar Association filed as an *amicus curiae*, noting that ''the Government's contention that *Morrison* does not apply to criminal charges brought under Section 10(b) contradicts a simple and commonsensical principle of statutory interpretation: the text of a statute can have only one authoritative meaning,''[31] and that the court '' 'must interpret the statute consistently, whether [it] encounter[s] its application in a criminal or civil context . . . .' ''[32] Accordingly, the Bar Association argues that it would be ''inconceivable . . . to give the language defining a Section 10(b) violation a narrow meaning for a private compensatory action and a more expansive meaning for a penal sanction.''[33] Oral argument was held on May 2, 2013.[34]

More recently, in *United States v. Martoma*,[35] defendant Mathew Martoma filed a motion to dismiss insider trading charges related to transactions in American depositary receipts (''ADRs'') tied to stock in Elan Corp., an Irish corporation traded on the Irish and London stock exchanges. Martoma, a former hedge fund portfolio manager for SAC Capital Advisors, argues that *Morrison* precludes criminal securities fraud prosecutions involving foreign transactions, as do the defendants in *Vilar* and *Mandell*. Martoma notes that ''courts in [the Second] Circuit have held that Section 10(b) is inapplicable to ADR transactions under *Morrison* because 'trade in ADRs is considered to be a predominantly foreign securities transaction' even where the ADRs are purchased on a U.S. exchange.''[36] Because ''ADRs are the functional equivalent of trading the underlying stock on a foreign exchange,'' Martoma urges, the ''economic reality is that ADRs are foreign transactions'' for the purpose of *Morrison*.[37] In its response, the Government argues that because ''there is *no dispute* that the Elan ADRs at issue were traded on the New York Stock Exchange,'' Martoma's conduct falls

[19] *Id.* at *9.
[20] *Id.* at *9.
[21] *Id.* at *9 n.11 (citing *SEC v. Goldman Sachs & Co.*, 790 F. Supp. 2d 147, 165 (S.D.N.Y. 2011)).
[22] *Id.* at *9.
[23] *Id.* at *10.
[24] *Id.* at *10.
[25] *United States v. Vilar*, No. 10-521 (2d Cir.).
[26] *United States v. Vilar*, No. 10-521, Dk. No. 178, Brief of Appellant Alberto Vilar (2d Cir. Sept. 28, 2011).
[27] 260 U.S. 94 (1922).
[28] *United States v. Vilar*, No. 10-521, Dk. No. 215, Brief for the United States of America at 97 (2d Cir. Mar. 26, 2012).
[29] *United States v. Mandell*, No. 12-1967 (2d Cir.).
[30] *United States v. Mandell*, No. 12-1967, Dk. No. 168, Brief for the United States of America (2d Cir. Dec. 20, 2012).
[31] *United States v. Mandell*, No. 12-1967, Dk. No. 115, Brief for Amicus Curiae the Association of the Bar of the City of New York in Support of Defendants-Appellants [hereinafter Brief of Mandell Amicus] at 26-27 (2d Cir. Sept. 25, 2012).
[32] *Id.* at 28 (quoting *Leocal v. Ashcroft*, 543 U.S. 1, 11-12 n.8 (2004)).
[33] Brief of Mandell Amicus, *supra* note 31 at 28.
[34] The court has asked for supplemental briefing from the parties regarding whether the trial record contains sufficient evidence of domestic transactions to support the convictions. *United States v. Mandell*, No. 12-1967, Dk. No. 217, Letter Requesting the Government to Submit Citations to the Appendix Where There Is Evidence of Domestic Transactions (2d Cir. May 2, 2013). Based on this request, the court may be attempting to avoid the fundamental legal question entirely, instead ruling that if the court below was in error in permitting evidence of foreign transactions to be considered, that error was harmless.
[35] *United States v. Martoma*, No. 1:12-cr-00973 (S.D.N.Y.).
[36] *United States v. Martoma*, No. 1:12-cr-00973, Dk. No. 39, Defendant Mathew Martoma's Memorandum of Law in Support of his Motion to Dismiss Count Two and the Corresponding Allegations in Count One of the Indictment [hereinafter Martoma Memorandum] at 1 (S.D.N.Y. June 28, 2013) (quoting *In re Société Générale Sec. Litig.*, No. 08 Civ. 2495 (RMB), 2010 BL 301673, at *4 (S.D.N.Y. Sept. 29, 2010)).
[37] Martoma Memorandum, *supra* note 36 at 14.

squarely within the first prong of *Morrison*, and his motion should be denied.[38] Accordingly, although the Government again maintains, as in *Vilar* and *Mandell*, that *Morrison* does not apply to criminal cases, the Government urges that the district court need not resolve that question to proceed in *Martoma*.[39] Trial is scheduled for November 4, 2013.

The Second Circuit's holdings in *Vilar* and *Mandell* will determine, at least in the Second Circuit, whether *Morrison* extends to criminal prosecutions, or if *Morrison* is limited strictly to civil litigation. If the court holds that *Morrison* does not apply to criminal prosecutions, it will create the perverse situation in which the primary federal agency charged with enforcement of the federal securities laws—the Securities and Exchange Commission—will be powerless to bring enforcement cases with respect to certain ostensible violations of the securities laws, whereas the Justice Department will be empowered to bring criminal cases regarding those same violations. This could create incentives for cases which would not otherwise be referred to the U.S. Attorney's Office by the SEC to be brought as criminal prosecutions because no other enforcement mechanism is available.

Did Congress Overrule *Morrison* With the Dodd-Frank Act?

More generally, there remains an open question as to the applicability of *Morrison* to civil and criminal enforcement actions for violations occurring after the passage of the Dodd–Frank Wall Street Reform and Consumer Protection Act (''Dodd-Frank'').[40] Section 929P(b)[41] of Dodd-Frank amended the jurisdictional provisions of the Securities Act, Exchange Act and the Investment Advisors Act of 1940 (the ''IAA'') to include a new subsection titled ''Extraterritorial Jurisdiction.'' New Section 27(b) of the Exchange Act reads as follows:

> The district courts of the United States and the United States courts of any Territory shall have jurisdiction of an action or proceeding brought or instituted by the [Securities and Exchange] Commission or the United States alleging a violation of the antifraud provisions of this title involving—
>
> (1) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors; or
>
> (2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States.[42]

By its literal terms then, Section 27(b) reintroduces the old Second Circuit ''conduct and effects'' test to extend the subject-matter jurisdiction of the federal courts to hear enforcement actions in connection with certain foreign transactions that would otherwise be beyond reach of the SEC and DOJ under *Morrison*. But as the Supreme Court was careful to explain in *Morrison*, the courts already have ample jurisdiction to hear any case to the extent it is based on a violation of the federal securities law; the issue in *Morrison* is not a jurisdictional question at all, but one of ''merits''—whether the fraudulent conduct complained of constitutes a *prima facie* violation of the federal securities laws at all.[43] Thus, the new ''Extraterritorial Jurisdiction'' subsections added by Section 929P of Dodd-Frank, read literally, have no effect at all.[44] We are not aware of any court having addressed in a holding the question of Section 929P's effect as of yet;[45] how future courts will rule in considering the meaning of Section 929P of Dodd-Frank remains to be seen.

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[38] *United States v. Martoma*, No. 1:12-cr-00973, Dk. No. 51, Government's Opposition to Defendant Mathew Martoma's Motion to Dismiss Count Two and the Corresponding Allegations in Count One of the Indictment at 4 (S.D.N.Y. July 19, 2013) (emphasis in original). Unlike the ADRs in *Martoma*, the ADRs at issue in *Société Générale*, upon which Martoma principally relies, were not U.S.-exchange traded, but rather traded in the over-the-counter market.

[39] *Id*. at 11.

[40] Dodd-Frank was signed into law on July 21, 2010, and became effective the following day.

[41] Pub. L. 111–203, 124 Stat. 1376, § 929(b).

[42] 15 U.S.C. § 78aa(b). The parallel provisions added to the Securities Act and the IAA are materially identical, with the exception that the new provision of the Securities Act is limited to applying to Section 17(a) thereof, while the new provision of the IAA is limited to applying to Section 206 thereof.

[43] *Morrison*, 130 S. Ct. 2869 at 2873. Notably, the Government did not reference Section 929P in either its *Vilar* or *Mandell* briefs; this is likely to be, at least in part, because conduct in those cases predated the passage of Dodd-Frank.

[44] Representative Paul Kanjorski, one of the principal drafters of Dodd-Frank, stated that Section 929P was ''intended to rebut'' the ''presumption against extraterritoriality'' in *Morrison* by ''clearly indicating that Congress intends extraterritorial application in cases brought by the SEC or the Justice Department.'' 156 Cong. Rec. H5237 (daily ed. June 30, 2010) (statement of Rep. Kanjorski). However, several commentators, in considering the language of Section 929P, have suggested that its wording in terms of ''jurisdiction'' constitutes a fatal drafting error that renders Section 929P superfluous. *See, e.g.*, Richard W. Painter, *The Dodd-Frank Extraterritorial Provision: Was It Effective, Needed or Sufficient?*, 1 HARV. BUS. L. REV. 195, 229 (2011) (''Congress passed a poorly drafted provision that may not do anything other than confer jurisdiction that courts already have, although Congress probably intended for it to do more'').

[45] In *Tourre*, the court stated in dicta that ''[b]ecause the Dodd-Frank Act effectively reversed *Morrison* in the context of SEC enforcement actions, the primary holdings of this opinion affect only pre-Dodd Frank conduct.'' *Tourre*, 2013 BL 145867, at *1 n.4.

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