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No. 08-1191

IN THE

Supreme Court of the United States

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

Petitioners,

v.

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

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR PETITIONERS

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QUESTION PRESENTED

Whether federal courts have subject matter jurisdiction under the Securities Exchange Act of 1934, 15 U.S.C. § 78a *et seq.*, over fraudulent conduct that occurred in the United States "by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . . ." *Id.*

PARTIES TO THE PROCEEDING

A list of all parties to the proceeding in the court whose judgment is under review is as follows:

Plaintiffs-Appellants and Petitioners: Russell Leslie Owen and Brian and Geraldine Silverlock, residents of Australia, and Robert Morrison, a resident of the United States.

Defendants-Appellees and Respondents: National Australia Bank ("NAB"); Frank Cicutto, an officer of NAB during the relevant time period; HomeSide Lending, Inc. ("HomeSide"), a Florida-based subsidiary of NAB; and Hugh Harris, Kevin Race and W. Blake Wilson, officers of HomeSide during the relevant time period.

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BRIEF FOR PETITIONERS

Petitioners respectfully request that the Court reverse the judgment of the United States Court of Appeals for the Second Circuit which affirmed the district court's dismissal of the complaint for lack of subject matter jurisdiction.

OPINIONS BELOW

The order of the United States District Court for the Southern District of New York, dated October 25, 2006, can be found at 2006 WL 3844465 (S.D.N.Y. Oct. 25, 2006). PA 23a.[1]

The panel opinion of the United States Court of Appeals for the Second Circuit, dated October 23, 2008, is officially reported at 547 F.3d 167 (2d Cir. 2008). PA 1a.

JURISDICTION

The ruling of the United States Court of Appeals for the Second Circuit sought to be reviewed was issued on October 23, 2008. On January 13, 2009, Justice Ginsburg granted an extension of time until March 23, 2009 in which to file a petition for a writ of certiorari. The petition for a writ of certiorari was filed on March

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[1] "PA" refers to the Appendix to the Petition for a Writ of Certiorari, which was filed on March 23, 2009. "JA" refers to the Joint Appendix, which was filed on January 19, 2010. "SA" refers to the Supplemental Appendix, also filed on January 19, 2010, which contains documents that were not legible when reduced to the size of the Joint Appendix.

23, 2009, and granted on November 30, 2009. The Court has jurisdiction to review the judgment of the United States Court of Appeals for the Second Circuit pursuant to 28 U.S.C. § 1254(1).

STATUTORY PROVISION INVOLVED

The primary statutory provision involved is 15 U.S.C. § 78j, which states as follows:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange –
>
> * * *
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement (as defined in Section 206B of the Gramm-Leach-Bliley Act), any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.
>
> Rules promulgated under subsection (b) of this section that prohibit fraud, manipulation, or insider trading (but not rules imposing or specifying reporting or recordkeeping

> requirements, procedures, or standards as prophylactic measures against fraud, manipulation, or insider trading), and judicial precedents decided under subsection (b) of this section and rules promulgated thereunder that prohibit fraud, manipulation, or insider trading, shall apply to security-based swap agreements (as defined in Section 206B of the Gramm-Leach-Bliley Act) to the same extent as they apply to securities. Judicial precedents decided under Section 77q(a) of this title and Sections 78i, 78o, 78p, 78t, and 78u-1 of this title, and judicial precedents decided under applicable rules promulgated under such sections, shall apply to security-based swap agreements (as defined in section 206B of the Gramm-Leach-Bliley Act) to the same extent as they apply to securities.

The primary code provision involved is 17 C.F.R. § 240.10b-5, which states as follows:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact

> necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

STATEMENT OF THE CASE

A. Factual Background

Petitioners' central allegations in the courts below concern Respondent HomeSide Lending, Inc. ("HomeSide"), which at one time was the sixth largest mortgage servicer in the United States. HomeSide was located in Jacksonville, Florida and at all relevant times was a wholly-owned subsidiary and agent of Respondent National Australia Bank ("NAB"). HomeSide was a mortgage service provider, meaning it serviced mortgages in return for a fee. Respondents Harris, Race and Wilson served as HomeSide's Chief Executive Officer, Chief Operating Officer, and Chief Financial Officer, respectively, from April 1999 until each man "resigned" on September 4, 2001.

Respondent NAB is organized under the laws of Australia and, at all relevant times, was that country's largest bank. NAB's ordinary shares trade on the Australian securities exchanges, and its American

Depositary Receipts ("ADRs")[2] traded on the New York Stock Exchange ("NYSE"). Respondent Frank Cicutto was Chief Executive Officer of NAB until February 2004.

Petitioners alleged that NAB, HomeSide and the individual defendants – Harris, Race and Wilson, then residents of Florida – violated the federal securities laws by intentionally overvaluing HomeSide's portfolio with the selection of improper mortgage prepayment speeds,[3]

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[2] "ADRs are investment vehicles for investors to register and earn dividends on non-U.S. stock without direct access to the overseas market itself. U.S.-based depository banks hold the overseas securities in custody in the country of origin and convert all dividends and other payments into U.S. dollars for receipt holders." W. Bailey, G. Andrew Karolyi, and C. Salva, *The Economic Consequences of Increased Disclosure: Evidence from International Cross-Listings* at 8, Ohio State University Publishing (Feb. 4, 2005). ADRs, as with the case at bar, typically move in tandem with the underlying security on its home exchange. Since NAB's ADRs were Level 3 ADRs under Securities Exchange Commission ("SEC") regulations, NAB was required to file with the SEC Forms 6 and 20, which are analogous to Forms 10-Q and 10-K filed with the SEC by United States corporations. It is not disputed that the ADRs were traded on the NYSE although ADR purchasers are not encompassed within the proposed plaintiff class.

[3] The mortgage industry has a standard measure for prepayment speeds, which measures the rate of prepayment of mortgage loans. For example, as interest rates go down, mortgage holders prepay and obtain new mortgages to secure lower rates. The faster the rate of these prepayments the lower the future earnings stream attributable to the underlying original "pool" of mortgages, which in turn was capitalized as an asset known as mortgage servicing rights, which appeared on the consolidated NAB balance sheet. JA 83a-84a.

in violation of Generally Accepted Accounting Principles, which respondents knew were incorrect and which were chosen solely in order to achieve over-inflated earnings targets. This overvaluation occurred in a declining interest rate environment in which customers were refinancing and paying off mortgages – by hundreds of millions of dollars – that were being serviced by HomeSide, and HomeSide's only real asset, its mortgage servicing rights ("MSR"), was disappearing. JA 117a-123a.

This fraudulent financial information was then transmitted to NAB in Australia. NAB incorporated this fraudulent information into its annual reports, reprinting the fraudulent financial information of HomeSide *line-by-line*. For example, in NAB's 1999 Annual Report, NAB listed, as a separate line item, the expenses and income of each of its wholly-owned subsidiaries, including HomeSide:

For years ended September 30 *Dollar in Millions, except percentage*	*1999*	*1998*
* * *		
HomeSide		
Other operating expenses	386	217
Operating income	640	387
%	60.3	56.1

SA-6. This separate line item was repeated in each of NAB's Annual Reports during the relevant time period, and similar financial information was included in the Form 20s filed by NAB with the Securities and Exchange

Commission ("SEC") during the relevant time period. SA-21, 26; SA-60.[4]

The central allegation of Petitioners' claims is that the fraudulent scheme occurred in Florida. HomeSide and the individual defendants engaged in a deceptive act and scheme whose principal purpose and effect was to create a false appearance of financial strength. JA 99a. In addition, every false statement made by NAB concerning HomeSide's operations, results and value was an exact repetition of the false financial information that HomeSide concocted in Florida for the very purpose of misleading NAB's shareholders about HomeSide's value and financial results.[5] JA 5a at A-1455.

When the accounting fraud was disclosed on September 3, 2001, NAB announced two massive

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[4] The court below found, *without any support in the record*, that the numbers HomeSide transmitted to NAB "had to pass through a number of checkpoints manned by NAB's Australian personnel before reaching investors." PA 21a. The Solicitor General, in her amicus brief opposing certiorari, unfortunately repeats this unfounded assertion. Brief of the United States As Amicus Curiae 5, 12, 15-16. As set forth in the express allegations of the complaint, NAB ministerially incorporated the fraudulent financial information it received from HomeSide. *See* Point II(B)(2), *infra*.

[5] Only the Consolidated Class Action Complaint, filed on January 30, 2004, appears in the Joint Appendix. Certain relevant facts are set forth in the Amended Consolidated Class Action Complaint, filed on December 26, 2006. Citations to these facts are to the relevant docket entry in the Joint Appendix and the page number of the document.

writedowns totaling well over three billion Australian dollars.[6]

B. NAB Participated In The Fraud At Homeside Through Its Activities In The United States

NAB directly participated in the affairs of HomeSide in the Florida subprime mortgage market. First, NAB, when it acquired HomeSide in February 1998, installed one of its Australian officers, Dave Thompson, at HomeSide. Thompson's position as an NAB Australian officer at HomeSide provided him with full access to and knowledge of the accounting fraud at HomeSide. Thompson had virtually daily contact with NAB as he monitored the business operations at HomeSide, and permitted the fraudulent activity to continue.[7] JA 5a at 1484.

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[6] After the revelation in September 2001 of the Australian $3.05 billion writedown that NAB was forced to book, NAB sold HomeSide to Washington Mutual, Inc., one of the primary participants in the subprime mortgage debacle. In September 2008, J.P. Morgan Chase & Co. purchased the banking assets of Washington Mutual, Inc.; the following day, Washington Mutual, Inc. filed for Chapter 11 voluntary bankruptcy. JA 5a at A-1394.

[7] In addition, NAB reported its MSR assets as a balance sheet line item in its Annual Reports. *See* SA-11; SA-36. The 1999 and 2000 Annual Report clearly disclosed that "[f]ollowing the acquisition of HomeSide in February 1998, [NAB] derives fees from mortgage servicing." SA-4; SA-21. Thus, investors knew that all mortgage servicing income of NAB was derived from HomeSide.

Second, NAB maintained offices on Park Avenue in New York City, SA-57,[8] at which traders, on behalf of HomeSide, engaged in complex financial transactions to hedge the outstanding mortgage exposure and exposure to interest rates that were present in HomeSide's portfolio. In setting up this hedge, NAB and HomeSide were trying to offset any losses in the HomeSide portfolio by a corresponding gain on the other side of the hedge; to be successful, the hedging strategy required that the traders accurately know the portfolio size and income stream from the expected mortgage payments. PA 76a-80a. The hedging activity in New York compounded the damage created by the fraud in Florida and, for example, in 1999 hedging losses totaled a staggering $1.4 billion and in 2000 another $480 million. JA 76a-80a. As a result of the hedging losses sustained by traders in NAB's New York office, NAB announced a writedown of the balance sheet value of HomeSide of $450 million on July 5, 2001, which NAB attributed to a failure of HomeSide's risk management systems. JA 5a at A-1261-64.

Finally, NAB officials received more than simply a warning; in July 2000, *HomeSide employees specifically*

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[8] NAB initially established its retail presence in the United States in 1995 with the purchase of Michigan National Corporation ("MNC"), whose principal subsidiary was Michigan National Bank ("MNB"). MNC was the third largest bank holding company in the State of Michigan and the 68th largest in the United States in terms of total assets as of June 30, 2000. As of September 30, 2000, MNC's total assets were $16 billion and MNB operated 184 outlets and 333 ATMs across the State of Michigan. NAB sold MNC to ABN AMRO in April 2001. PA 5a at 448, 999.

notified NAB that HomeSide was engaged in accounting fraud. In July 2000, several HomeSide employees "blew the whistle" on the fraud that they witnessed taking place at HomeSide's offices in Florida. The employees sent a letter to Cicutto and members of NAB's risk management group in Melbourne. JA 89a. The letter did not simply say that there was an unspecified fraud taking place at HomeSide; rather, the letter detailed the specific processes that individual defendants Harris, Race and Wilson and others were using to manipulate the prepayment and discount rate assumptions HomeSide used to value its MSR, the business's most significant asset. In addition, the whistle-blowing employees directed Cicutto and NAB's risk management team to specific electronic files that contained data which confirmed and documented the fraudulent scheme. Thus, for more than 13 months prior to NAB's disclosure that it would write off A$3.5 billion due to problems at HomeSide, NAB and Cicutto had direct knowledge of the fraud that was used to make NAB's financial situation appear significantly better than it actually was. JA 90a.

C. The District Court Opinion

The foregoing allegations of fraud were all committed in the United States through the instrumentalities of interstate commerce and the United States mails. Nonetheless, the district court, in an Opinion entered on October 26, 2004, dismissed the claims against NAB on the grounds that the district court did not have subject matter jurisdiction over the claims brought by foreign plaintiffs or based on transactions conducted on foreign exchanges. PA 42a. Subject matter jurisdiction

would be limited to securities transactions in the United States, and the district court set out that in order to maintain a claim, Petitioners would have "leave to substitute a lead domestic plaintiff and to otherwise amend the pleadings with respect to ADR purchasers only." PA 45a.

The district court entered final judgment on January 16, 2007.

D. The Second Circuit Decision

A three-judge panel of the Second Circuit heard oral argument on July 18, 2008. The panel invited the SEC to submit an amicus brief on whether the antifraud provisions of the United States securities laws apply to fraud perpetrated in the United States by a foreign company. PA 48a.

According to the SEC:

> The antifraud provisions of the securities laws apply to transnational frauds that result exclusively or principally in overseas losses if the conduct in the United States is material to the fraud's success and forms a substantial component of the fraudulent scheme.

PA 48a. Applying this standard to the allegations in Petitioners' complaint, the SEC concluded that "material and substantial conduct in furtherance of the alleged fraud occurred in the United States so as to support application of the antifraud provisions . . . ." PA 49a-50a.

The Second Circuit, without any analysis of the SEC's position, held that there was no subject matter jurisdiction, because "the alleged fraud [did not] affect[ ] American investors or America's capital markets." PA 20a. The court below reasoned that "[t]he actions taken and the actions not taken by NAB in Australia were . . . significantly more central to the fraud and more directly responsible for the harm to investors than the manipulation of the numbers in Florida." *Id.* at 19a. This justified dismissal: "while HomeSide may have been the original source of the problematic numbers, those numbers had to pass through a number of checkpoints manned by NAB's Australian personnel before reaching investors." *Id.* The Second Circuit held that American securities laws only reach harms "perpetrated abroad which have a substantial impact on investors or markets within the United States," notwithstanding where the fraud occurs. PA 7a (quoting *Europe & Overseas Commodity Traders, S.A. v. Banque Paribas London,* 147 F.3d 118, 125 (2d Cir. 1998)).

According to the Second Circuit, because the effects of the conduct were not realized in the United States, the fraudulent conduct was rendered beyond the reach of American securities laws. The Second Circuit accordingly affirmed the district court in dismissing all claims concerning transactions that did not occur on the American exchanges, while allowing any claims based on transactions in the United States to be asserted separately. PA 23a.

SUMMARY OF THE ARGUMENT

This is a case about statutory construction. In Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78a *et seq.* (the "Exchange Act"), Congress declared that

> "[i]t shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . . [t]o engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

15 U.S.C. § 78j(b).

By the express terms of the statute, a federal violation occurs whenever a fraud is committed in connection with the purchase or sale of *any security* under one of the three conditions. The Exchange Act is violated if a person uses any means or instrumentality of interstate commerce ***or*** uses the United States mails ***or*** uses any facility of any national securities exchange to perpetrate a securities fraud. Under ordinary rules of statutory construction, the disjunctive "or" means that any one of the three conditions is a basis for subject matter jurisdiction.[9]

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[9] When interpreting a statute, "[i]t is our duty 'to give effect, if possible, to every clause and word of a statute.'" *Duncan v. Walker*, 533 U.S. 167, 174 (2001) (quoting *United*

(Cont'd)

Here, Petitioners clearly alleged that NAB had engaged in fraudulent conduct in connection with the sale of securities and that this fraud was perpetrated through interstate commerce in this country and through the use of the United States mails. JA 40a. The court below decided to truncate the Exchange Act and ignore two of the three conditions that Congress had made actionable, making actionable only fraudulent conduct that implicated a national securities exchange in the United States. All other claims, according to the court below, would be dismissed for want of subject matter jurisdiction. In unceremonious fashion, the Court of Appeals for the Second Circuit dropped two of the predicate conditions for actionable securities fraud from the statute that Congress had passed and the President had signed.

As is well-established in the Court's case law on subject matter jurisdiction, the lower federal courts are without authority to disclaim the subject matter jurisdiction that Congress has given them. This is the rule that the Court explicitly set out in *Arbaugh v. Y&H Corp.*, 546 U.S. 500, 503 (2006), and then reiterated unanimously just this Term in *Union Pacific Railroad Co. v. Brotherhood of Locomotive Engineers & Trainmen General Committee of Adjustment, Central Region*, 130 S. Ct. 584, 596 (2009) ("*Union Pacific*").

(Cont'd)

States v. Menasche, 348 U.S. 528, 538-39 (1955)). "Canons of construction ordinarily suggest that terms connected by a disjunctive be given separate meanings, unless the context dictates otherwise." *Reiter v. Sonotone Corp.*, 442 U.S. 330, 339 (1979).

Although the court below did not have the benefit of *Union Pacific* at the time of its ruling, the error is unmistakable under that holding or the holding in *Arbaugh*.

ARGUMENT

I. Contrary To The Express Language Of The Exchange Act, And Contrary To The Court's Recent Holdings In *Arbaugh* And *Union Pacific,* The Courts Below Improperly Dismissed The Complaint Solely On The Grounds Of Subject Matter Jurisdiction

A. The Court Should Vacate The Decision Below Because It Is Inconsistent With *Arbaugh* And *Union Pacific* And Remand In Light Of *Union Pacific*

The only issue addressed below was whether there is subject matter jurisdiction over securities fraud that occurs in the United States, but which is then inflicted on foreign investors through an overseas exchange. The facts of record make clear that the connection to the United States was not a matter of happenstance, but was the very essence of the fraud alleged. As summarized by the Second Circuit, "By March of 2000, HomeSide, as a wholly owned subsidiary of NAB, held the rights to service $18 billion of mortgages, making it America's sixth biggest mortgage service company." PA 3a. The fraud alleged involved HomeSide's accounting practices in the United States, *id.*, and that fraud was perpetrated through SEC filings, annual reports of HomeSide, and press releases, PA 4a, all of

which occurred in the United States and all of which involved interstate commerce and the U.S. mails. Nor given the enormity of the subprime mortgage calamity in the American economy is a fraud of this magnitude of no concern to American finance.

Despite the allegations that the fraud was concocted and executed in Florida, the Second Circuit held this conduct to be outside the reach of the federal securities laws. The court below, as well as other courts of appeals that have addressed the issue of the reach of Section 10(b), have consistently framed the issue as one of "subject matter jurisdiction." *See*, *e.g.*, PA 22a ("we lack subject matter jurisdiction").

This ruling cannot stand. Twice in the past few Terms, the Court has had to instruct lower federal courts that subject matter jurisdiction is a matter of statutory construction and is not a question of the strength of the averments made or the proofs offered in the particular case. In *Arbaugh*, this Court addressed concerns that courts were conflating and confusing subject matter jurisdiction with the need to prove the essential elements of a claim for relief: "We have described such unrefined dispositions as 'drive-by jurisdictional rulings' that should be accorded 'no precedential effect' on the question whether the federal court had authority to adjudicate the claim in suit." 546 U.S. at 511 (quoting *Steel Co. v. Citizens for Better Env't.*, 523 U.S. 83, 91 (1998)).

The Court in *Arbaugh* adopted a "bright line" test to determine whether a statute was jurisdictional or whether the allegations of a particular case were

independently part of the merits of inquiry of the case. The test, the Court in *Arbaugh* explained, is as follows:

> If the Legislature clearly states that a threshold limitation on a statute's scope shall count as jurisdictional, then courts and litigants will be duly instructed and will not be left to wrestle with the issue. But when Congress does not rank a statutory limitation on coverage as jurisdictional, courts should treat the restriction as nonjurisdictional in character.

Id. at 515-16 (citation and footnote omitted). Therefore, subject matter jurisdiction is governed by the language of the jurisdictional provisions of the statute.

Indeed, as the Court reaffirmed this Term, "[s]ubject-matter jurisdiction properly comprehended . . . refers to a tribunal's 'power to hear a case,' a matter that 'can never be forfeited or waived.'" *Union Pacific*, 130 S. Ct. at 596 (quoting *United States v. Cotton*, 535 U.S. 625, 630 (2002)). In *Union Pacific*, the Court addressed whether "written documentation of the conference in the on-property record is a necessary prerequisite to arbitration" under the Railway Labor Act ("RLA"). *Id.* at 595. The Court's clear holding was again that jurisdiction is defined by the express language of the statute, not by the proof in the particular case: "nothing in the [RLA] elevates to jurisdictional status the obligation to conference minor disputes or to prove conferencing." *Id.* at 595-96.

In *Arbaugh*, the question presented was whether subject matter jurisdiction under Title VII turned on the minimum number of employees requirement. The Court held that the statutory provisions governing jurisdiction over Title VII suits did not contain any employee-numerosity requirement and the numerosity requirement at issue was set forth in a separate provision that did "not speak in jurisdictional terms." *Arbaugh*, 546 U.S. at 514-15. In *Union Pacific*, the statutory grant of authority under the RLA did not contain a subject matter jurisdiction requirement of "conferencing." 130 S. Ct. at 588. In both cases, the Court directed the lower court or agency to proceed with the case because the particular requirement at issue was not jurisdictional.

As set forth below, the Exchange Act does not contain a statutory limitation that would limit the reach of the Act only to frauds that have an effect on American purchasers or American exchanges. Accordingly, since the statutes do not rank effects in the United States as jurisdictional, this Court "should treat the restriction as nonjurisdictional in character," *Arbaugh*, 546 U.S. at 515, and reverse and remand the suit for further proceedings.

The Second Circuit's holding diminishes the effectiveness of the Exchange Act. As the SEC argued below, and as advanced by the Solicitor General in her opposition to the writ of certiorari, the jurisdictional ruling would not only result in the dismissal of the present action, but would divest the SEC of critical enforcement powers under the very same statute. Based on its experience in overseeing securities markets that

increasingly engage in global transactions, the SEC proposed the following test to the court below:

> The antifraud provisions of the securities laws apply to transnational frauds that result exclusively or principally in overseas losses if the conduct in the United States is material to the fraud's success and forms a substantial component of the fraudulent scheme.

PA 48a. As previously noted, the SEC took the position that Petitioners' complaint satisfied this standard. PA 49a-50a.

The Solicitor General refined this test and also concluded that Respondents' actions as alleged in the Complaint also satisfied the subject matter jurisdiction test advanced by the government.

> [I]t is sufficient if the scheme involves significant conduct within the United States that is material to the fraud's success. The allegations in petitioners' complaint satisfy that standard. According to those allegations, the false information that was released to the public in Australia was generated in the United States with the expectation that it would be incorporated into NAB's financial statements. The conduct of HomeSide and its officers within the United States thus was not peripheral or merely preparatory, but was an integral component of the overall

> scheme . . . . To the extent the court of appeals concluded that the scheme as alleged did not violate Section 10(b), its analysis is incorrect.

Brief For The United States As Amicus Curiae 13.

B. The SEC's "Materiality" And "Substantiality" Test Is Proper Under The Exchange Act

Jurisdiction over claims alleging violations of the Exchange Act is established by 15 U.S.C. § 78aa. That statutory provision provides that the district courts "shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of ***all*** suits in equity and actions at law brought to enforce ***any*** liability or duty created by this chapter or the rules and regulations thereunder." 15 U.S.C. § 78aa (emphasis added).

Congress could have made the geography of the fraudulent scheme "jurisdictional," just as it had made an amount-in-controversy threshold an ingredient of subject matter jurisdiction under 28 U.S.C. § 1331 prior to 1980. Neither the Exchange Act's jurisdictional provision, 15 U.S.C. § 78aa (authorizing jurisdiction over suits "to enforce" the Act) nor, for that matter, 28 U.S.C. § 1331, specifies any threshold amount of harm in the U.S. as a jurisdictional ingredient akin to the monetary floor provision that was part of § 1331 prior to 1980.

Indeed, the relevant section of the Exchange Act, 15 U.S.C. § 78j, does not focus on the geography of the fraudulent scheme at all. It is irrelevant under the plain language of the Exchange Act whether the fraudulent

scheme was conceived and executed in whole or in part outside the United States. Rather, the plain language of the statute makes actionable the manner in which conduct is perpetrated, not the point of sale of the securities in question. The statute and the implementing regulation make it unlawful,

> "by the use of any means or instrumentality of interstate commerce ***or*** of the mails, ***or*** of any facility of any national securities exchange . . . [t]o engage *in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,* in connection with the purchase or sale of any security."

17 C.F.R. § 240.10b-5 (emphasis added)

The Second Circuit rejected the statutory test for one of its own crafting. Relying on its own case law, the court below wrote, "we look to whether the harm was perpetrated here or abroad *and* whether it affected domestic markets and investors." PA 8a. Certainly Congress could have created, had it so wished, a domestic fraud statute that would open a "Barbary Coast" safe harbor for fraud that occurred here but led to injury abroad. *SEC v. Kasser*, 548 F.2d 109, 116 (3d Cir.), *cert. denied*, 431 U.S. 938 (1977). No such jurisdictional safe harbor is present in the Exchange Act. Yet, this is what the Second Circuit created, thereby allowing an unregulated launching point for fraud generated in the United States, so long as the ultimate transaction was elsewhere. Thus, for the Second Circuit the dispositive fact was that the fraudulent scheme "culminated abroad," PA 9a, a jurisdictional line that finds no support in the statutory language.

In applying the bright-line test of *Arbaugh* to this case, the extent to which the harms were felt in the United States or Australia "is an element of a plaintiff's claim for relief, not a jurisdictional issue." *Arbaugh*, 546 U.S. at 516. By contrast, jurisdiction turns on whether the fraudulent scheme relied upon the instrumentalities of interstate commerce or the U.S. mails. The SEC, in its amicus brief submitted to the court below, opined that Petitioners' allegations of a massive accounting fraud perpetrated by HomeSide in Florida stated a claim under the federal securities laws. *See* PA 77a ("the Commission believes that the allegations in this case satisfy the proposed standard governing subject matter jurisdiction set forth by the SEC") (emphasis added). As emphasized again in *Union Pacific*, lower courts are not free to jettison those parts of subject matter jurisdiction not to their liking. Subject matter jurisdiction can only be created – or limited – by Congress.

II. Petitioners Have Properly Asserted Subject Matter Jurisdiction In This Case

A. By Its Terms, The Exchange Act May Apply To Foreign Commerce

Petitioners, in their complaint, set forth three theories for defendants' liability under Section 10(b) of the Exchange Act: (1) a scheme "designed to defraud by representations," *Pasquantino v. United States*, 544 U.S. 349, 357 (2005) (quoting *Durland v. United States*, 161 U.S. 306, 313 (1896)); (2) scheme liability under Section 10(b); and/or (3) a misrepresenta-tion claim under Section 10(b). Although the court below only

looked at item (3), all of these theories are actionable under the Exchange Act for unlawful conduct in the United States, based on interstate commerce or the mails. The claims set forth are based on the exercise of legislative power to proscribe certain conduct that occurs within the territory of the United States, which Congress did in Section 10(b).

The expansive reach of Section 10(b) to all fraud-related activity undertaken in the territorial United States is not accidental. Beginning with the preamble to the Exchange Act, the statutory purpose is clearly to reach beyond conduct affecting only Americans or the American exchanges: "To provide for the regulation of securities exchanges . . . operating in interstate and *foreign commerce* and through the mails, to prevent inequitable and unfair practices on such exchanges . . . ." 48 Stat. 881 (1934) (emphasis added).

As to the scope of the conduct proscribed, Section 10 of the Act, 15 U.S.C. § 78j, prohibits "any person" from employing, even indirectly, "any means or instrumentality of interstate commerce" in contravention of rules against manipulative and deceptive devices proscribed by the SEC. "Interstate commerce" is defined by the Exchange Act to include "trade, commerce, transportation, or communication . . . between *any foreign country and any state* . . . ." 15 U.S.C. § 78c(a)(17) (emphasis added).[10]

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[10] Moreover, although the Court need not reach the question, Petitioners here have alleged a violation of Section 10(b) and Rule 10b-5. Rule 10b-5(a) makes it unlawful for "any

(Cont'd)

The allegations of securities fraud in this suit, which are based on HomeSide documents disclosed by "whistleblowers" who were employed by HomeSide, arise from the calculation of HomeSide's mortgage servicing rights ("MSR") flowing from its conduct in the Florida subprime mortgage market. This overvaluation scheme was conceived and implemented by defendants in the United States; the fraudulent overvaluations were generated in the United States; and defendants then transmitted this fraudulent information to Australia for incorporation into NAB's financial statements. NAB incorporated this fraudulent information into its annual reports, reprinting the fraudulent financial statements of HomeSide *line-by-line*. As set out in the complaint, every false statement made by NAB concerning HomeSide's operations, results and value was a repetition of the false financial information that HomeSide fabricated in Florida for the very purpose of misleading NAB's shareholders about HomeSide's value and financial results. JA 5a at A-1455.

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person," "directly or indirectly," to "employ any device, scheme, or artifice to defraud." 17 C.F.R. 240.10b-5(a). This Court has held that "any manipulative or deceptive device or contrivance" in Section 10(b) includes a "scheme; often, a scheme to deceive," *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 197, 199 n.20 (1976) (citing the definition of "contrive" in Webster's International Dictionary (2d ed. 1934) as "to fabricate"), and that Section 10(b) applies to "complex securities fraud" in which "there are likely to be multiple violators." *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 191 (1994). Rule 10b-5(c) makes it unlawful for "any person," "directly or indirectly," to "engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person . . . ." 17 C.F.R. 240.10b-5(c).

The information that rendered the statements in Australia false was fabricated in the United States with the expectation that it would be distributed to foreign and domestic investors. Without this domestic misconduct, there would have been no fraudulent release of information in Australia nor a resulting inflation of NAB's stock. As argued by the SEC and the Solicitor General, the domestic conduct was a substantial and material link in the chain of events leading to the foreign investors' losses. The misconduct in Florida was primary, not secondary; central, not incidental. This fraudulent scheme violated the "rules and regulations as the Commission may prescribe . . .", 15 U.S.C. § 78j, namely, Rule 10b-5(a) and (c).[11] Since Petitioners have

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[11] In *Stoneridge Investment Partners, LLC v. Scientific-Atlantic, Inc.*, 552 U.S. 148 (2008), the Court held, *inter alia*, that: (a) allegations regarding complicit participation by outside vendors in a cable company's fraudulent scheme took place in the realm of ordinary business transactions governed by state law, not the realm of securities markets governed by the SEC; (b) the outside vendors' alleged deceptive acts were not communicated to the public; and (c) defendants had no duty to disclose the alleged transactions. Thus, plaintiffs did not satisfy the reliance element of Section 10(b) and Rule 10b-5 and, therefore, could not allege scheme liability under Section 10(b). *Id.* at 159-61. Here, however, HomeSide was a wholly-owned subsidiary and agent of NAB and, along with the HomeSide individual defendants, were central to NAB's false and misleading conduct, which was in the securities realm and inflated the price of NAB's securities. Furthermore, the HomeSide defendants' misconduct and deceptive acts were communicated to the public through NAB's disclosure of its consolidated financials. SA-4; SA-21 ("following the acquisition of HomeSide in February 1998, [NAB] derives fees from mortgage servicing").

stated a prima facie claim for relief under the Exchange Act, the Court should not proceed further. The Court should reverse the court below and remand the suit for further proceedings.

B. The Court Should Adopt The Test Employed By The Solicitor General And The SEC For Securities Fraud

Once the question of statutory implementation is taken outside the improper mold of subject matter jurisdiction, then the limited case law[12] on transnational fraud claims supports the "material and substantial" test suggested by the SEC and reframed by the Solicitor General as: whether "the scheme involves significant conduct within the United States that is material to the fraud's success." Brief For The United States As Amicus

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[12] Although the court below used the language of "f-cubed" and "transnational" cases, the central allegations in this case concern activities in the Florida subprime mortgage market. Even so, the extent of "transnational" securities fraud cases in the federal courts appears to be modest. According to Cornerstone Research, class action securities filings against "corporations headquartered outside the United States," as a percentage of total filings, peaked in 2007 at 16.4% (of a total of 177 filings), and declined in each of the last two years, first to 13.5% (of a total of 223 filings), and then 12.4% (of a total of 169 filings). Cornerstone Research, *Securities Class Action Filings - 2009: A Year in Review*, at 11 (2010), available at http://securities.cornerstone.com. Moreover, these percentages overstate the number of filings against truly "foreign" issuers, since many corporations "headquartered outside the United States" are multinational organizations with a major presence in the United States.

Curiae at 13. Such a test both recognizes the reality of pervasive transnational effects in a globalized economy, but also affords proper respect to the sovereign interests of multiple nations in frauds not neatly confined within territorial boundaries.

Further, the SEC's and Solicitor General's positions conform to longstanding principles recognized in American law. Such overlapping state interests in fraud perpetrated across national boundaries is anticipated by the Restatement of Law (Third) The Foreign Relations Law Of The United States in discussing the different sorts of national interests that might be implicated. The Restatement identifies certain of these interests as follows:

> for example, when one state exercises jurisdiction on the basis of territoriality and the other on the basis of nationality; or when one state exercises jurisdiction over activity in its territory and the other on the basis of the effect of that activity in its territory; or when a given activity or transaction, such as international trade or transport, takes place in or affects more than one state.

Restatement (Third) of Foreign Relations Law § 403 (Limitations on Jurisdiction to Prescribe) cmt. d (1987).

The Restatement then proposes a test that dovetails with the test suggested by the SEC and the Solicitor General. According to the Restatement: "The United States may generally exercise jurisdiction to prescribe with respect to . . . conduct occurring predominately in the United States that is *related to* a transaction in

securities, *even if the transaction takes place outside the United States*." *Id.* § 416 (Jurisdiction to Regulate Activities Related to Securities) (emphasis added). Further, the Restatement makes clear that it applies to "situations in which it is generally reasonable for the United States to exercise jurisdiction under § 402(1)(a) (territoriality), even as applied to securities sold outside the United States or to persons who are not United States nationals or residents." *Id.* cmt. a.[13]

Applying this test, HomeSide's and NAB's activity in the United States was at the very least part of a single fraudulent scheme to inflate NAB's stock price.[14]

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[13] Moreover, "[t]he reasonableness of the exercise of jurisdiction depends not only on the territorial links of a given activity with the United States, but also on *the character* of the activity to be regulated. Thus, *an interest in punishing fraudulent or manipulative conduct is entitled to greater weight than are routine administrative requirements*." *Id.* cmt. a (emphases added).

[14] Roughly contemporaneously with the passage of the Exchange Act, the first Restatement of Conflict of Laws anticipated the same outcome: "If consequences of an act done in one state occur in another state, each state in which any event in the series of acts and consequences occurs may apply its law to the event." Restatement of Conflict of Laws: Events Consequent On Act Done In Another State § 70 (Final Drafts Nos. 1-2, 1930). With respect to misrepresentations, the Restatement in 1930 also provided that "[w]hen a communication is sent from one state to another, each state has jurisdiction over the communication." Restatement (First) of Conflict of Laws: Communications Sent From One State To Another § 71 (Final Drafts Nos. 1-2, 1930).

As expressed by the Reporter, Professor Joseph H. Beale, in *A Treatise on the Conflict of Laws* in 1935, a bullet fired from (Cont'd)

In place of the approaches proffered by the SEC or by the Restatement, the court below relied on an erroneous definition of a purported "lengthy chain of causation between the American contribution to the misstatements and the harm to investors." Pet. App. 21a. As a result, the court below held that:

> while HomeSide may have been the original source of the problematic numbers, those numbers had to pass through a number of checkpoints manned by NAB's Australian personnel before reaching investors. While HomeSide's rigging of the numbers may have contributed to the misinformation, *a number of significant events needed to occur before this misinformation caused losses to investors*. This lengthy chain of causation between what HomeSide did and the harm to investors weigh against our exercising subject matter jurisdiction.

Id. (emphasis added).

This conclusion of law confuses unbroken acts of fraud from independent conduct that breaks the causal

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one state into another injuring someone who then dies in a third state implicates the laws of each of the three states. Professor Beale invoked a case in which "the defendant mailed poisoned candy in California to a person in Delaware; the latter ate the candy and died. The defendant was convicted of homicide, under the statute, in California." Joseph H. Beale, *A Treatise on the Conflict of Laws*, Vol. 1, § 65.2 at 315-316 (Baker, Voorhis & Co. 1935) (footnotes omitted).

chain. In *Anza v. Ideal Steel Supply Corp.*, 547 U.S. 451, 482 (2008), the Court found that conduct outside an alleged antitrust conspiracy defeated the claimed causal connection: "ordinary competitive actions undertaken by the defendant competitor cut the *direct* causal link between the plaintiff competitor's injuries and the forbidden acts" (Breyer, J. concurring in part and dissenting in part) (emphasis in original).

This same reasoning cannot be applied here. To begin with, the clear allegations in this case are that the fraud was perpetrated in the U.S., included in filings before the SEC, and that the Australian acts were simply ministerial inclusions – the very reasons identified by the SEC and the Solicitor General as giving rise to subject matter jurisdiction. *Nowhere in the record is there any evidence of any review by, or supposed checkpoints at, NAB*. To the contrary, Petitioners alleged that NAB mechanically incorporated the numbers provided to it by HomeSide as separate line items in its financial statements. JA 5a at A-1455.

Second, the Second Circuit erroneously applied the law of intervening cause. The law of intervening cause assumes an independent causal factor that is not part of the same course of conduct by an independent actor. It must be an outside, independent force that breaks the chain of causation. "A superseding cause is an act of a third person or other force which by its intervention prevents the action from being liable for harm to another which his antecedent negligence is a substantial factor in bringing about." W. P. Keaton, *Prosser and Keaton on Torts*, § 44 at 301 n.1 (5th ed. 1984) (quoting Second Restatement of Torts § 440). Compare *Bridge*

v. Phoenix Bond & Indem. Co., 128 S. Ct. 2131, 2144 (2008) (plaintiffs were permitted to sue under RICO because "there are no independent factors that account for respondents' [economic] injury. . ."), with *Anza*, 547 U.S. at 482 (Breyer, J. concurring in part and dissenting in part) ("it is not a 'proximate cause,' if the causal chain from the forbidden act to the injury caused a competitor proceeds through a legitimate business's ordinary competitive activity").

C. The Test Suggested By The Solicitor General And The SEC Would Resolve The Split Among The Circuits

The "materiality" and "substantiality" test set forth by the SEC and the Solicitor General would resolve the split among the circuits concerning "the sort of conduct occurring in the United States that ought to be adequate to trigger American regulation of the transaction." *Kauthar SDN BHD v. Sternberg*, 149 F.3d 659, 665 (7th Cir. 1998). The courts below have divided between the restrictive test of the District of Columbia Court of Appeals, *Zoelsch v. Arthur Andersen & Co.*, 824 F.2d 27, 31 (D.C. Cir. 1987) ("jurisdiction will be in American courts where the domestic conduct comprises all the elements of a defendant's conduct necessary to establish a violation of Section 10(b) and Rule 10b-5"), and the more expansive but imprecise standard of the Third, Eighth and Ninth Circuits, which "generally require *some lesser quantum of conduct*." *Robinson v. TCI/US W. Commc'ns, Inc.*, 117 F.3d 900, 906 (5th Cir. 1997) (emphasis added). *See, e.g.*, *Kasser*, 548 F.2d at 114 (conduct comes within the scope of the Exchange Act if "at least some activity designed to further a

fraudulent scheme occurs within the country"); *Continental Grain (Austl.) Pty. Ltd. v. Pacific Oilseeds, Inc.*, 592 F.2d 409, 421 (8th Cir. 1979) (Exchange Act provisions applicable when the domestic conduct "was in furtherance of a fraudulent scheme and was significant with respect to its accomplishment").

The test proposed by the SEC and the Solicitor General builds on the Restatement and sets forth a unified standard that would provide greater guidance to the lower courts in resolving future cases. The materiality inquiry would ensure that the domestic conduct was an integral link in the chain of events in the transnational fraud leading to the foreign investors' losses. The substantiality showing would generally be satisfied by demonstrating that a sufficient quantum of conduct occurred in the United States reasonably to warrant application of the Exchange Act.

III. Application Of American Law To Unlawful Conduct Committed In The United States Comports With Traditional Powers Of Sovereignty And Territoriality

A. The Traditional Anglo-American Concept Of Sovereignty Is Based Centrally On Territory

The power of American law to govern all conduct within the nation's territory, regardless of the interest that any foreign nation might also have in such conduct, has been beyond dispute. *See Schooner Exch. v. McFaddon*, 11 U.S. (7 Cranch) 116, 136 (1812) (Marshall, C.J.) ("The jurisdiction of the nation within its own territory is necessarily exclusive and absolute. It is

susceptible of no limitation not imposed by itself."); Restatement (Third) of Foreign Relations Law § 402, cmt. c (2009) ("The territorial principle is by far the most common basis for the exercise of jurisdiction to prescribe, and it has generally been free from controversy"). *See* Joseph Story, *Commentaries on the Conflict of Laws* §§ 18-19 at 21-22 (1865) ("The first and most general maxim or proposition is . . . that every nation possesses an exclusive sovereignty and jurisdiction within its own territory . . . the sovereign may in like manner make laws for foreigners, who even pass through his territories . . . for the preservation of order within his dominion.").

The Court has confronted the application of American law to conduct taking place outside the United States. The presumption established in these cases, frequently invoked by foreign defendants and Americans acting abroad, is that, without a clear statement to the contrary, Congress intends to legislate only for conduct within the United States' territory. *Foley Bros. v. Filardo*, 336 U.S. 281, 285 (1949). The corollary is an equally fundamental presumption that, without a clear statement to the contrary, Congress intends to legislate for conduct within the territory of the United States. That presumption holds regardless of the interest that any foreign nation might also have in such conduct. Both of these presumptions are merely partial expressions of the still more fundamental principle articulated by Justice Holmes – and, before him, by the courts of England – that "[a]ll legislation is prima facie territorial." *American Banana Co. v. United Fruit Co.*, 213 U.S. 347, 356 (1909) (quoting *Ex parte Blain*, L.R. 12 Ch. Div. 522, 528 (1879)).

The presumption that Congress intends to legislate for all conduct within the United States regardless of the potential interest of other nations in such conduct is, essentially, the presumption invoked by this Court in *Spector v. Norwegian Cruise Line Ltd.*, 545 U.S. 119 (2005), regarding the presumptive reach of American law "to foreign-flag cruise ships in United States waters." *Id.* at 125-27.

Describing the presumption that it was applying, the Court stated:

> It is reasonable to presume Congress intends no interference with matters that are primarily of concern only to the ship and the foreign state in which it is registered. It is also reasonable, however, to presume Congress does intend its statutes to apply to entities in United States territory that serve, employ, or otherwise affect American citizens, or that affect the peace and tranquility of the United States, even if those entities happen to be foreign-flag ships.

Id. at 131-32.

The Court relied on the longstanding case authority of *Mali v. Keeper of the Common Jail*, 120 U.S. 1, 12 (1887) ("*Wildenhus's Case*"), which refused a demand by the Belgian consul that Belgium be entitled to prosecute a murder aboard a Belgian ship that was moored at an American port. The fact of American territorial sovereignty trumped Belgium's interest in prosecuting the killing of one of its citizens by another of its citizens. *Id.* at 18.

B. Application Of American Securities Fraud Law To Conduct In The United States Does Not Offend The Principles Of Foreign Relations Law Even If Foreign Nationals Also Are Affected

Independent of its ruling on subject matter jurisdiction, the Second Circuit correctly observed that the potential for conflict between the "the anti-fraud sections of the securities laws" and foreign laws is minimal, because "anti-fraud enforcement objectives are broadly similar as governments and other regulators are generally in agreement that fraud should be discouraged." PA 17a. (quoting Judge Friendly in *ITT, An Int'l Inv. Trust v. Cornfeld*, 619 F.2d 909, 921 (2d Cir. 1980)). The court below added that, "[t]he primary interest of [a foreign state] is in the righting of a wrong done to an entity created by it. If our anti-fraud laws are stricter than [a foreign state's], that country will surely not be offended by their application." *Id.* Thus, "[t]he problem of conflict between our laws and those of a foreign government is much less of a concern when the issue is the enforcement of the anti-fraud sections of the securities laws than with such provisions as those requiring registration of persons or securities." *Id.*

The Second Circuit's conclusion in this regard is fully supported by the Restatement, which concludes that, when the law of American securities fraud is applied, "the likelihood of conflict with regulation by other states is slight." Restatement (Third) of Foreign Relations Law

§ 416 (1987). Summarizing its findings, the Restatement observes that,

> [i]n contrast to regulation under the antitrust laws which not infrequently involved prohibition of conduct which another state favored or required, United States securities regulation (other than transnational discovery efforts) has not resulted in state-to-state conflict . . . . [N]o instance is known in which a transaction challenged under United States law such as misrepresentation or insider trading – was asserted to be mandated or encouraged by the law of a foreign state.

Id. (citations omitted). *See also* Hannah L. Buxbaum, *Multinational Class Actions Under Federal Securities Law: Managing Jurisdictional Conflict*, 46 Colum. J. Transnat'l L. 14, 62 (2007) ("the extraterritorial application of U.S. law in the area of securities regulation has simply not generated the same level of difficulty and hostility as extraterritorial regulation in other areas").

Applying American securities laws to fraudulent conduct that originated in the United States does not conflict with *Microsoft Corp. v. AT&T Corp.*, 550 U.S. 437 (2007), nor *F. Hoffman-La Roche Ltd. v. Empagran S.A.*, 542 U.S. 155 (2004), which rejected specific extraterritorial applications of, in turn, the United States patent and antitrust laws. The patent and antitrust laws at issue in *Microsoft* and *F. Hoffmann-La Roche*, unlike the fraud provisions of the securities laws, are expressly limited by their own terms to

violations where both the underlying conduct and the injury occurred in the United States.

Thus "[t]he traditional understanding that our patent law 'operate[s] only domestically and d[oes] not extend to foreign activities' is embedded in the Patent Act itself, which provides that a patent confers exclusive rights in an invention within the United States." *Microsoft*, 550 U.S. at 455 (citation omitted). Moreover, the general rule is supported by the fact that "in the area here involved, in particular, foreign law 'may embody different policy judgments about the relative rights of inventors, competitors, and the public in patented inventions.'" *Id.*

Similarly, the Foreign Trade Antitrust Improvements Act of 1982 ("FTAIA"), Pub. L. No. 97-290, 96 Stat. 1246, "set[s] forth a general rule stating that the Sherman Act 'shall not apply to conduct involving trade or commerce . . . with foreign nations.'" *F. Hoffmann-La Roche*, 542 U.S. at 158 (quoting 15 U.S.C. § 6a). The only exception, also provided by the FTAIA, is "where the conduct (1) has a 'direct, substantial, and reasonably foreseeable effect' on domestic commerce, and (2) 'such effect gives rise to a [Sherman Act] claim,'" *id.* at 159 (quoting 15 U.S.C. §§ 6a(1)(A), (2)). Moreover, the general rule is supported by the fact that "[n]o one denies that America's antitrust laws, when applied to foreign conduct, can interfere with a foreign nation's ability independently to regulate its own commercial affairs," *id.* at 165, and that "even where nations agree about primary conduct, say, price fixing,

they disagree dramatically about appropriate remedies." *Id.* at 167.[15]

By contrast to the Patent Act and Sherman Act, the antifraud provisions of the securities laws do not contain any language confining their application to violations involving conduct and injuries occurring in the United States, and there is no record of conflicts between the securities fraud provisions of the United States and those of foreign nations. Therefore, any presumption against extraterritorial statutory application has far less basis here than in *Microsoft* or *F. Hoffmann-La Roche.*

IV. The Standard Urged By Petitioners Is Consistent With International Comity

A. Congress Already Took Comity Concerns Into Account In Expressly Providing For The Application Of The Exchange Act To International Commerce

Any comity concerns raised by the application of the antifraud provisions of the Exchange Act to foreign transactions were addressed by Congress in enacting that legislation. While the courts have often remarked that the Exchange Act is "silent as to its extraterritorial application," *e.g.*, *Itoba Ltd. v. LEP Group, LLC*, 54 F.3d

[15] The Patent Act, 35 U.S.C. § 271(f), creates an exception for a certain kind of conduct in the United States that causes an injury that occurs outside the United States; whereas, the FTAIA, 15 U.S.C. §§ 6a(1)(A) & (2), creates an exception for conduct outside the United States that causes an injury inside the United States.

118, 121 (2d Cir. 1995), the Exchange Act and its accompanying regulations in fact anticipate that issue.

Thus, Section 10(b) and Rule 10b-5 by their terms apply to securities fraud conducted "by the use of any means or instrumentality of interstate commerce." 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5. The Exchange Act in turn defines "interstate commerce" to include "trade, commerce, transportation, or communication among the several States, *or between any foreign country and any State* . . . ." 15 U.S.C. § 78c(a)(17) (emphasis added). Rule 10b-5 thus applies to foreign trade by its terms. Moreover, in setting forth the necessity for securities regulation, the Exchange Act included a Congressional finding that "prices established and offered in [securities] transactions are generally disseminated and quoted throughout the United States *and foreign countries* . . . ." 15 U.S.C. § 78b(2) (emphasis added).

Further suggesting congressional awareness of the foreign dimensions of the Exchange Act is Section 30 of the Exchange Act. The first subsection of Rule 30 makes it illegal for "any broker or dealer" to engage in transactions on foreign exchanges that violate rules promulgated pursuant to the Act (such as Rule 10b-5) in any securities issued by United States residents. 15 U.S.C. § 78dd(a). With respect to non-broker dealers, Section 30(b) goes on to provide:

> The provisions of this chapter or of any rule or regulation thereunder shall not apply to any person insofar as he transacts a business in securities without the jurisdiction of the

> United States, *unless he transacts such business in contravention of the such rules and regulations as the Commission may prescribe as necessary or appropriate to prevent evasion of this chapter.*

15 U.S.C. § 78dd(b) (emphasis added).[16]

The standard urged by Petitioners, the Solicitor General, and the SEC will permit the courts to make flexible case-by-case determinations of the extraterritorial applicability of the antifraud provisions of the Exchange Act, insuring that the interests of comity will be furthered and not offended by each application, notwithstanding the Court's refusal to allow such a case-by-case approach to be used under the express statutory framework of the antitrust laws. *F. Hoffman-LaRoche*, 542 U.S. at 168-69.[17]

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[16] Two of the Circuits have considered, in passing, the impact of Section 30(b) in the context of the extraterritorial. application of Section 10(b). *Zoeslch*, 824 F.2d at 31-32 ; *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 984 n.20 (2d Cir. 1975) (Friendly, J.). The salient point is that Congress showed in Section 30 that it was cognizant of the extraterritorial ramifications of the statute, and it knew how to limit the extraterritorial application in particular cases (*i.e.*, broker-dealers), but yet did nothing to limit the statute otherwise.

[17] In addition, district court judges could seek guidance from the United States Department of State as to whether an application of United States law to a foreign securities transaction would violate United States diplomatic policy. In cases where the "act of state" doctrine would ordinarily prevent

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B. Comity Concerns Can Also Be Addressed By Application Of The *Forum Non Conveniens* Doctrine

Concerns relating to comity can also be addressed by application of the *forum non conveniens* doctrine, which gives courts the discretion to decline to hear cases that would more appropriately be heard in a foreign forum. The factors considered by the courts in determining whether to decline to hear a case on this ground include such comity-based ones as the foreign forum's greater interest in having the subject matter tried locally. *See Gulf Oil Corp. v. Gilbert*, 330 U.S. 501, 508 (1947) (federal courts have discretion to decline to hear cases within their jurisdiction, based on a number of public and private interest factors).

Indeed, the Court has praised the flexibility of the *forum non conveniens* doctrine, as it is "not . . . a rigid rule to govern discretion," but rather lets "'each case turn[ ] on its facts.'" *Piper Aircraft Co. v. Reyno*, 454 U.S. 235, 249 (1981) (quoting *Williams v. Green Bay & W. R. Co.*, 326 U.S. 549, 557 (1946)). The Court emphasized in *Piper* the valuable role *forum non conveniens* plays in preventing favorable United States law from turning the United States courts into a magnet

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United States courts from adjudicating the conduct of foreign governments, the Department of State has submitted "Bernstein letters" advising the courts when that department has determined that such adjudication would not violate United States interests. *See, e.g., First Nat'l City Bank v. Banco Nacional de Cuba*, 406 U.S. 759, 764 (1972).

for foreign plaintiffs by giving the courts discretion to decline to hear cases whose connection with the United States is tenuous. *See Piper*, 454 U.S. at 251-52. In fact, district courts have declined to hear securities class actions brought by foreign plaintiffs on precisely this basis. *See, e.g., Warlop v. Lernout*, 473 F. Supp. 2d 260 (D. Mass. 2007) (dismissing on *forum non conveniens* grounds an action by Belgian investors who had purchased stock in a Belgian company on a European Exchange and then sued the outside directors in the United States).

In sum, comity concerns should not lead the Court to adopt a bright-line rule against private actions by foreign purchasers. There are other, more flexible ways to deal with such concerns.[18]

V. The Solicitor General's Argument Seeking Dismissal Of Petitioners' Claims – Even Though They Satisfy The Subject Matter Jurisdiction Test – Is Not Supported By The Statute

Petitioners believe that the test for substantial and material relation between the fraud and activity in the United States, as formulated by the Solicitor General

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[18] In addition, unlike the case here where personal jurisdiction did not play a role, limited contacts by foreign parties, such as mere participation in the ADR market, would also act to incorporate indirectly comity concerns by placing such a defendant outside the personal jurisdiction of American courts. *See Pinker v. Roche Holdings Ltd.*, 292 F.3d 361, 372 (3d Cir. 2002) (sponsorship of ADRs only provides specific personal jurisdiction for ADR purchasers).

and the SEC, provide the proper analytic framework for determining the reach of American securities laws. As both the SEC in the Second Circuit and the Solicitor General in this Court have argued, under such standards the fact that Florida was the center of the fraudulent conduct readily satisfied the test for subject matter jurisdiction. Indeed, it is difficult to imagine a financial harm that has had more devastating impact on the American economy than securities fraud based on fraudulent subprime mortgages.

In her opposition to certiorari, however, the Solicitor General for the first time argued that even though the statutory basis for subject matter jurisdiction had been met, the complaint should nonetheless be dismissed. Brief For The United States As Amicus Curiae 14-15. In support of this argument, the Solicitor General maintained that because private actions under the Exchange Act are what is termed "implicit" rights of action, they should be construed to limit those who may seek remedies thereunder, and that therefore the Second Circuit's holding should be affirmed – even if the Solicitor General rejected every part of the reasoning below.

This argument has never been pressed in any court below and, to the best of our knowledge, has never been addressed by any court of appeals in any matter.[19] Nor

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[19] In *Union Pacific*, the Court reaffirmed the long-standing rule that a respondent may "rely upon any matter appearing in the record in support of the judgment." 130 S. Ct. at 595 (quoting *Blum v. Bacon*, 457 U.S. 132, 137 n.5 (1982)). There is nothing in the record below that raises the question of a distinction between SEC and private enforcement actions.

was this position advanced by the SEC in its filing before the Second Circuit. Even if the Solicitor General were free to raise any argument in support of affirmance, the Court should not entertain a position from the government contrary to its prior filings in the same action without affording the lower courts a chance to test the claim.

Further, the Solicitor General's argument appears to retread in unaltered fashion the position taken in *Stoneridge* four years ago. At the time, the Solicitor General argued for a limit to aiding and abetting liability in private suits. *Stoneridge Inv. Partners, LLC*, No. 06-43, Brief For The United States As Amicus Curiae Supporting Affirmanance, filed August 15, 2007, Point C of Argument. The government's brief at the time did not address statutes such as the Private Securities Litigation Reform Act, 15 U.S.C. § 78u-4 *et. seq.* ("PSLRA"), or the Securities Litigation Uniform Standards Act, 15 U.S.C. § 78bb(f) ("SLUSA"), which designed a detailed litigation regime for private securities fraud claims. In *Stoneridge*, the Court did indeed limit the scope of aiding and abetting liability, but rejected the rationale put forward by the Solicitor General. Instead, the Court read the PSLRA in particular to have "ratified the implied right of action" that had previously been a judicial construct. 552 U.S. at 165. As recognized by the Court in *Stoneridge*, Congress in the PSLRA limited to the SEC the power to enforce claims for aiding and abetting liability. *Id.* at 162-63. The PSLRA did *not* distinguish between public and private enforcement *on any other claim* under the Exchange Act.

Surprisingly, the Solicitor General's opposition to certiorari again does not address the PSLRA (nor even cite to it), and argues in identical fashion as it did in *Stoneridge* about diffuse inherent limitations on the securities private right of action. Most surprisingly, the Solicitor General does not address the Court's ruling in *Stoneridge* with respect to aiding and abetting. Nowhere mentioned is Congress's actions with respect to potential aiding and abetting liability, nor the Court's recognition in *Stoneridge* of the definitive effect of the PSLRA.

CONCLUSION

For the reasons set forth above, the decision of the United States Court of Appeals for the Second Circuit should be reversed and the case remanded to the Second Circuit in light of *Union Pacific*.

Respectfully submitted,

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