JONES DAY

COMMENTARY

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Recent Second Circuit Decisions Assess Territorial Reach of Securities and Commodities Laws

IN SHORT

The Situation: The Second Circuit has issued two decisions in recent months that have addressed whether the U.S. securities and/or commodities laws can be applied to transactions with significant foreign ties. Each of these decisions focused on the "domestic transaction" prong of the test established in *Morrison v. National Australia Bank Ltd.* for evaluating the territorial reach of the securities laws.

The Results: The Second Circuit concluded, in both decisions, that applying U.S. law would not be impermissibly extraterritorial, even though the transactions at issue had significant foreign components.

Looking Ahead: The Second Circuit will have yet another opportunity to evaluate the territorial reach of the U.S. commodities laws in *In re North Sea Brent Crude Oil Futures Litigation*, No. 17-2233. In that case, the parties have extensively briefed the issue of whether the transactions were so "predominantly foreign" that U.S. commodities laws should not apply.

The Playing Field Prior to *Choi* and *Giunta*

In the landmark *Morrison* decision in 2010, the U.S. Supreme Court held that Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") does not apply extraterritorially, and that the statute therefore can be applied only to: (i) "transactions in securities listed on domestic exchanges"; and (ii) "domestic transactions in other securities." While the Supreme Court indicated that this two-prong test was intended to promote consistent and predictable results, it did not provide clear guidance on the types of transactions that would qualify as appropriately "domestic" under the second prong. In the absence of such guidance, in 2012, the Second Circuit held in the *Absolute Activist Value Master Fund Ltd. v. Ficeto* decision that "in order to adequately allege the existence of a domestic transaction, it is sufficient for a plaintiff to allege facts leading to the plausible inference that the parties incurred irrevocable liability within the United States."

The *Choi* Decision

In *Choi v. Tower Research Capital LLC*, the Second Circuit addressed allegations that the defendants, a high frequency trading firm and its founder, violated the Commodity Exchange Act ("CEA") by engaging in manipulative "spoofing" transactions on the Korea Exchange ("KRX"). In particular, the defendants were alleged to have engaged in manipulative transactions on the "night market" for KRX futures. This allowed market participants to place their futures orders on the KRX during overnight hours when the exchange was closed, have their orders electronically matched on the CME Globex trading platform in the United States, and then have their transactions settled and cleared on the KRX when it re-opened for business the following morning.

The district court initially granted the defendants' motion to dismiss the plaintiffs' claims under the CEA, holding that the transactions at issue did not involve products listed on a domestic exchange and also could not be considered "domestic transactions" under *Morrison*. The Second Circuit rejected the district court's application of the "domestic transaction" prong of *Morrison*, concluding that the plaintiffs plausibly alleged that parties to futures transactions on the KRX "night market" incurred "irrevocable liability" for such transactions when their orders were matched on the CME Globex platform in the United States. The Second Circuit concluded that these allegations were sufficient to overcome the defendants' motion to dismiss on extraterritoriality grounds.

Choi and *Giunta* suggest that the Second Circuit is willing to broadly interpret the 'domestic transaction' prong of *Morrison*.

The *Giunta* Decision

In *Giunta v. Dingman*, the Second Circuit addressed allegations that the defendants violated Section 10 (b) of the Exchange Act by making misrepresentations in connection with the sale of an equity stake in a company incorporated in the Bahamas. As in *Choi*, the securities at issue in *Giunta* were not listed on a domestic exchange, so the Second Circuit evaluated whether the sale satisfied the "domestic transaction" prong of *Morrison*. The Second Circuit concluded that since the plaintiff accepted the defendants' offer to purchase the shares while he was in New York, he incurred "irrevocable liability" for the transaction in the United States, and the transaction could be considered "domestic" for purposes of the Exchange Act.

In *Giunta*, the Second Circuit specifically addressed—but ultimately rejected—the defendants' argument that even if the transaction was considered "domestic" under *Morrison*, the plaintiff's claims were so

"predominantly foreign" that applying the Exchange Act would be impermissibly extraterritorial. The Second Circuit concluded that the foreign components of the transaction were not as significant as those in *Parkcentral Global HUB Ltd. v. Porsche Automobile Holdings SE*, and therefore held that the "predominantly foreign" exception it created in *Parkcentral* did not apply.

Impact Going Forward

When read in tandem, *Choi* and *Giunta* suggest that the Second Circuit is willing to broadly interpret the "domestic transaction" prong of *Morrison*, such that many transactions with significant foreign ties will be subject to claims in the United States. However, *Giunta* suggests that the Second Circuit may still be willing to apply the "predominantly foreign" exception it created in *Parkcentral* to certain securities/commodities transactions.

Significantly, the Second Circuit did not evaluate in *Choi* whether the "predominantly foreign" exception applied to the claims at issue, despite the fact that: (i) the futures orders at issue were placed in Korea (and related to the price of a Korean stock index); (ii) the plaintiffs were all Korean citizens; and (iii) the futures transactions were settled and cleared in Korea. As a result, it remains unclear when this judicially created exception should apply.

THREE KEY TAKEAWAYS

1. In evaluating the territorial reach of the federal securities and commodities laws, the Second Circuit continues to focus on the location where the parties incurred "irrevocable liability" for their transactions.
2. For transactions executed on an electronic trading platform (like those in *Choi*), "irrevocable liability" is likely to be incurred where the buy and sell orders are matched, rather than where they settle or clear.
3. By failing to provide clear guidance on when the "predominantly foreign" exception it created in *Parkcentral* applies, the Second Circuit has left the door open for inconsistent and unpredictable results, which is precisely what the Supreme Court sought to avoid in *Morrison*.

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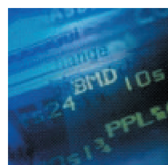

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