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Outside Counsel

'Morrison's' Impact on Claims Under the Commodity Exchange Act

Two recent decisions emanating from the Southern District of New York have extended the underlying logic of the Supreme Court's landmark 2010 decision in *Morrison v. National Australia Bank*,[1] which limited the extraterritorial reach of section 10(b) of the Securities Exchange Act of 1934, to claims brought under the Commodity Exchange Act.[2] These decisions continue the trend among courts to interpret *Morrison's* presumption against extraterritoriality broadly and extend its reach beyond section 10(b).

'Transactional Test'

In *Morrison*, the Supreme Court limited the extraterritorial application of section 10(b) of the Securities Exchange Act (the Exchange Act), the primary antifraud provision of the federal securities laws. Under the bright-line "transactional test" articulated in *Morrison*, section 10(b) applies only in connection with the purchase or sale of a security listed on a domestic exchange or the domestic purchase or sale of any other security.

In its analysis, the court reasoned that the Exchange Act's silence as to the extraterritorial application of section 10(b) warranted application of the presumption against extraterritoriality—a canon of statutory construction. The court concluded, "[w]hen a statute gives no clear indication of an extraterritorial application, it has none."[3] As applied to the plaintiffs' claims in *Morrison*, the transactional test precluded the investors from recovering under U.S. securities law because the National Australia Bank shares at issue traded on a foreign exchange and none of the purchases or sales occurred in the United States.

TODD G. COSENZA *is a partner in the litigation department of Willkie Farr & Gallagher.* HAYLEY T.J. TOZESKI, *an associate at the firm, contributed to this article.*

By
Todd G. Cosenza

In *Morrison*, the court did not need to reach the issue of what constitutes a "domestic" transaction under section 10(b) for securities not listed on a U.S. exchange. Within a year of the court's decision, the Second Circuit confronted that very issue in *Absolute Activist Value Master Fund v. Ficeto*.[4] In *Absolute Activist*, foreign hedge funds sued their investment manager under section 10(b) for purchasing penny stocks at artificially inflated prices to pump up management fees. Because the stocks did not trade on a U.S. market, the Second Circuit had occasion to define the domestic transaction prong of *Morrison*.

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The court concluded that a transaction is domestic "if irrevocable liability is incurred or liability passes within the United States."[5] The court then affirmed the dismissal of the funds' complaint because the "sole allegation" affirmatively stating the transactions took place in the United States did so "in conclusory fashion," without reference to "the formation of the contracts, placement of purchase orders, passing of title, and the exchange of money."[6]

Commodity Exchange Act

The Commodity Exchange Act (CEA) regulates the trading of commodity futures in the United States. Analogous to the Exchange Act's antifraud provisions, the CEA provides: "It shall be unlawful for a commodity trading advisor…by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly…to employ any device, scheme, or artifice to defraud any client or participant or prospective client or participant."[7] Two recent decisions from the Southern District (*Starshinova v. Batratchenko* and *In re LIBOR-Based Financial Instruments Antitrust Litigation*) have agreed that *Morrison* applies with equal force to the CEA—limiting the CEA's extraterritorial application.

'Starshinova v. Batratchenko.' In *Starshinova*, Russian investors alleged that Oleg Batratchenko, a U.S. citizen living in Russia, and 13 foreign and domestic companies controlled by Batratchenko, the "Thor Entities," perpetrated a massive fraud involving plaintiffs' contributions to investment funds managed by defendants. According to plaintiffs, defendants represented that the funds were invested in stable, high yield, liquid investments, including U.S. and foreign stocks, commodities, and real estate and that their investments were redeemable within 20 days.

On the heels of the 2008 economic crisis, certain of Batratchenko's funds declined by 50 percent due, in part, to defendants' illiquid real estate investments. After defendants refused to honor their request to redeem investments in the funds, plaintiffs sued Batratchenko and the Thor Entities in the Southern District of New York, asserting claims under the CEA and the Exchange Act and claims for breach of contract, fraud, and breach of fiduciary duty. The defendants moved to dismiss. Relying on *Morrison* and the presumption against extraterritoriality, defendants argued that plaintiffs' failure to allege that any of the trades occurred on U.S. exchanges or that the transactions at issue occurred within the United States was fatal to their CEA and Exchange Act claims.

On March 15, 2013, the district court sided with defendants and held that, after *Morrison*, neither the CEA nor the Exchange Act govern the transactions challenged by the plaintiffs. In analyzing the Exchange Act claims, the court first noted that the plaintiffs did not allege the shares of the Thor Entities they purchased were listed on an American exchange. Instead, plaintiffs focused on the second *Morrison* prong, alleging that they transacted with defendants in the United States when they purchased ownership interests in one of the Thor Entities. Plaintiffs argued that since the Thor Entities' parent company had a principal place of business in New York, Batratchenko attended meetings in New York, and certain funds invested in New York real estate, defendants became irrevocably bound to sell the Thor shares in New York.

The court disagreed noting that under *Absolute Activist*, "the only[] consideration is whether or not the parties became 'bound to effectuate a transaction'—either to take and pay for, or to deliver, a security—in the United States."[8] The court found that the connections to New York alleged in the complaint did not support a plausible inference that defendants incurred irrevocable liability here.

The court then turned to the CEA claims. The court noted that pre-*Morrison* case law "squarely determined that section 4 of the CEA does not affirmatively indicate that it applies extraterritorially."[9] The court next examined the text of the provision under which plaintiffs based their claim—section 4o of the CEA —which makes it unlawful for a commodity trading advisor by means of interstate commerce "to employ any device, scheme, or artifice to defraud any client…or prospective client…or to engage in any transaction, practice, or course of business which operates as a fraud or deceit" upon the same. The court again found that there is "no language in §4o to support a finding that it applies extraterritorially."[10]

And, given the clear "parallel" between the Exchange Act and the CEA, the court concluded that *Morrison* abrogated the conduct and effects test for claims under the CEA as it had claims under the Exchange Act. Further, because the scope of private rights of action under section 10(b) of the Exchange Act is the "same" as section 4 of the CEA, the court concluded that the irrevocable liability test set forth by the Second Circuit in *Absolute Activist* applied. As a result, plaintiffs' CEA claims were barred for the same reasons that their Exchange Act claims were dismissed.

'In re LIBOR-Based Financial Instruments Antitrust Litigation.' This multidistrict litigation arose out of the alleged manipulation of the London InterBank Offered Rate (LIBOR) by members of the banking trade association responsible for calculating LIBOR. The defendant financial institutions allegedly conspired to submit artificial rates for their expected cost of borrowing U.S. dollars from other institutions. The average of those rates was then published and that average, LIBOR, was used as a benchmark interest rate in worldwide financial instruments.

In their complaint, plaintiffs (private investors in financial instruments affected by LIBOR) alleged that they suffered harm during a 34-month period during which defendants supposedly submitted artificially deflated rates that lowered the final computed average of LIBOR. Plaintiffs claimed that the lowering of LIBOR, in turn, negatively impacted various financial instruments in which plaintiffs had invested.

In 'Starshinova,' given the clear 'parallel' between the Exchange Act and the CEA, the court concluded that 'Morrison' abrogated the conduct and effects test for claims under the CEA as it had claims under the Exchange Act.

Recently, the district court dismissed plaintiffs' antitrust, RICO, and state law claims. The court did not, however, dismiss certain CEA claims premised upon plaintiffs' investments in Eurodollar futures contracts.[11] In the briefing on defendants' motion to dismiss, the parties agreed that *Morrison* governs the extraterritorial application of the CEA. The court agreed and explained that, under *Morrison*, absent an "'affirmative intention of the Congress clearly expressed'" to give a statute extraterritorial application, it must be presumed it has none.[12]

The court then examined what domestic activities Congress intended the CEA to regulate. Focusing on section 9(a)(2), under which plaintiffs asserted their claims, the CEA made it a crime for "[a]ny person to manipulate or attempt to manipulate the price of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity." The court interpreted this language to mean that Congress intended to regulate commodities in interstate commerce and futures contracts traded on domestic exchanges (like the Eurodollar futures contracts disputed here). As a result, those CEA claims are, according to the court, actionable in the United States.

Defendants had argued that plaintiffs actually alleged the manipulation of the Eurodollar Time Deposits—the commodities underlying the futures contracts—which are not traded on domestic exchanges. The court disagreed. According to the court, because LIBOR is directly incorporated into the price of the futures contracts, plaintiffs sufficiently alleged that defendants manipulated the price of those contracts, which "is precisely the conduct that the CEA was designed to regulate."[13]

Implications

Starshinova and *In re LIBOR* represent important expansions of *Morrison* outside of the context of traditional equity and debt securities. These decisions further evince the strong trend among district courts to interpret *Morrison's* presumption against extraterritoriality broadly. Perhaps even more importantly, it reinforces the notion that whenever presented with a question of extraterritorial application of congressional legislation, district courts will attempt to discern a clear, affirmative intent in the statute's text that it applies extraterritorially before expanding the statute's reach to conduct and trades that take place abroad. Lastly, these decisions illustrate the uphill battle plaintiffs will continue to face when seeking redress under federal law for investment-related losses regarding vehicles that do not trade on domestic exchanges.

1. 130 S. Ct. 2869 (U.S. 2010).
2. See *Starshinova v. Batratchenko*, No. 1:11-cv-09498, 2013 WL 1104288 (S.D.N.Y. March 15, 2013); *In re LIBOR-Based Fin. Instruments Antitrust Litig.*, No. 11 MD 2262, 2013 WL 1285338 (S.D.N.Y. March 29, 2013).
3. *Morrison*, 130 S. Ct. at 2878.
4. 677 F.3d 60 (2d Cir. 2012).
5. Id. at 67.
6. Id. at 70.
7. 7 U.S.C. §6o(1).
8. *Starshinova*, 2013 WL 1104288, at *5.
9. Id. at *6.
10. Id. at *7.
11. Eurodollar futures contracts are based upon Eurodollar Time Deposits, USD $1 million deposits in commercial banks outside of the United States with a three-month maturity. The price of Eurodollar futures contracts, which trade on the Chicago Mercantile Exchange, is indexed to LIBOR such that, plaintiffs alleged, the artificial suppression of LIBOR caused the contracts (commodities under the CEA) to trade and settle at artificially inflated prices.
12. *In re LIBOR-Based Fin. Instruments Antitrust Litig.*, 2013 WL 1285338, at *19.
13. Id. at *21.