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Third Circuit Defines "Extraterritorial" Applicability of Federal Securities Laws in United States v. Georgiou

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The U.S. Court of Appeals for the Third Circuit added its voice yesterday to the ongoing judicial effort to construe the U.S. Supreme Court's 2010 decision in *Morrison v. National Australia Bank*, concerning the extent to which the federal securities laws apply to securities transactions involving transnational elements. The *Morrison* decision had held that the Securities Exchange Act's anti-fraud provisions apply only to transactions involving the purchase or sale of (*i*) "a security listed on an American stock exchange" and (*ii*) "any other security in the United States."

In an appellate case of first impression, the Third Circuit ruled in *United States v. Georgiou* that the OTC Bulletin Board (the "OTCBB") and the Pink OTC Markets Inc. (the "Pink Sheets") are not "American stock exchanges" under *Morrison*'s first prong. The court also held that transactions in "securities issued by U.S. companies through U.S. market makers acting as intermediaries for foreign entities" satisfy *Morrison*'s second prong and are subject to the federal securities laws. This ruling on *Morrison*'s second prong follows decisions from the Second and Eleventh Circuits concerning the locus of transactions in securities not listed on U.S. stock exchanges.

The *Georgiou* Case

The *Georgiou* case involved efforts to manipulate markets of four stocks of U.S. issuers. The co-conspirators had opened brokerage accounts outside the United States and had used them to engage in manipulative trading of the U.S. stocks, thereby inflating the stocks' prices and creating the false impression of an active market in each stock. The defendants were convicted of securities fraud, wire fraud, and conspiracy.

On appeal, the defendants contended that their securities-fraud convictions had been improperly based on extraterritorial application of U.S. law, without any proof that the securities transactions had occurred in the United States. The defendants argued that the evidence did not support application of either of *Morrison*'s two prongs. The Third Circuit affirmed the convictions.

The Third Circuit agreed that *Morrison*'s first prong – for purchases or sales of "a security listed on an American stock exchange" – did not apply. The court observed that, according to the SEC, 18 registered national security exchanges exist, and the OTCBB and the Pink Sheets are not among them. The court also noted that the Exchange Act's distinction between "securities exchanges" and "over-the-counter markets" "suggests that one is not inclusive of the other."

But the court held that the evidence satisfied *Morrison*'s second prong – for U.S. transactions in unlisted securities. Under *Morrison*, the "location of the transaction" determines whether the Exchange Act applies to a purchase or sale of unlisted securities. The Third Circuit agreed with the Second Circuit that "'the point of [incurring] irrevocable liability can be used to determine the locus of a securities purchase or sale.'" "'[C]ommitment' is a simple and direct way of designating the point at which . . . the parties obligated themselves to perform what they had agreed to perform even if the formal performance of their agreement is to be after a lapse of time.'" Accordingly, "territoriality under *Morrison* turns on 'where, physically, the purchaser or seller committed him or herself' to pay for or deliver a security."

The Third Circuit explained that "[f]acts that demonstrate 'irrevocable liability' include the 'formation of the contracts, the placement of purchase orders, the passing of title, or the exchange of money.'" "On the other hand, heavy marketing in the United States, a party's residency or citizenship, and the fact that the deception may have originated in the United States [are] insufficient to support a Section 10(b) claim."

Applying this standard, the Third Circuit held that the facts here supported application of the Exchange Act. At least one of the fraudulent transactions in each of the four stocks had taken place through U.S.-based market-makers – "i.e., an American market maker bought the stock from the seller and sold it to the buyer." Thus, "some of the relevant transactions required the involvement of a purchaser or seller in the United States, incurring irrevocable liability in the United States, or passing title in the United States." In addition, the record contained evidence "of specific instances in which the [stocks] were bought or sold at Georgiou's direction from entities located in the United States." The evidence therefore satisfied *Morrison*'s second prong – for "domestic transactions" in unlisted securities – under the "irrevocable liability" standard.

Georgiou's Implications

The *Georgiou* decision – although the only appellate ruling squarely deciding this point – should resolve any question about whether the OTCBB and the Pink Sheets are "American stock exchanges" under *Morrison*'s first prong. (The Eleventh Circuit had previously ruled in *United States v. Isaacson* that trading on the OTCBB and the Pink Sheets and evidence suggesting securities purchases in the United States were "enough to satisfy *Morrison*'s conditions," but the opinion did not specifically hold that trades on the OTCBB and the Pink Sheets themselves satisfied *Morrison*'s first prong, for U.S.-listed securities.)

The decision also aligns the Third Circuit with the Second Circuit (and the Eleventh Circuit) on an irrevocable-liability standard for "domestic transactions" in unlisted securities under *Morrison*'s second prong. But although the Third Circuit relied heavily on the Second Circuit's analysis, the court did not discuss the Second Circuit's latest word on transnational securities transactions in *ParkCentral Global Hub Limited v. Porsche Automobile Holdings SE*. In that case, the Second Circuit declined "to proffer a test that will reliably determine when a particular invocation of [the Exchange Act's anti-fraud provision] will be deemed appropriately domestic or impermissibly extraterritorial"; instead, it held that, at least in some circumstances, even a U.S. domestic transaction might not be covered by the Exchange Act if the imposition of liability on foreign defendants would otherwise constitute an impermissibly extraterritorial extension of the statute.

The *Porsche* case involved a different set of facts: the foreign defendants in that case had not had any involvement with the plaintiffs' securities transactions; the defendants' conduct had been largely foreign; the securities at issue had not been stock, but, rather, securities-based swap agreements that referenced the price movements of foreign securities; and the plaintiffs had been private actors seeking damages, rather than the U.S. Government seeking to enforce U.S. law. The Third Circuit perhaps saw no need to explain or distinguish the *Porsche* case based on the evidence presented in the *Georgiou* trial involving U.S. stocks, U.S. market-makers, and U.S. transactions.

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