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VIA EMAIL: rule-comments@sec.gov

February 17, 2011

Ms. Elizabeth M. Murphy
Secretary, Securities and Exchange Commission
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Re: Study on Extraterritorial Private Rights of Action (File No. 4-617)

Dear Ms. Murphy:

We represent investment funds in a case on appeal to the United States Court of Appeals for the Second Circuit (*Elliott Associates, L.P. et al. v. Porsche Automobil Holding SE*, 10 Civ. 0532 (HB) (S.D.N.Y)). We submit this letter in response to the Commission's request for comments in Release No. 34-63174. That request for comments addresses the extent and scope of private rights of action under the antifraud provisions of the Securities Exchange Act of 1934 following the Supreme Court's decision in *Morrison v. National Australia Bank*, 130 S. Ct. 2869 (2010). This letter responds to two calls for comment in the Release:

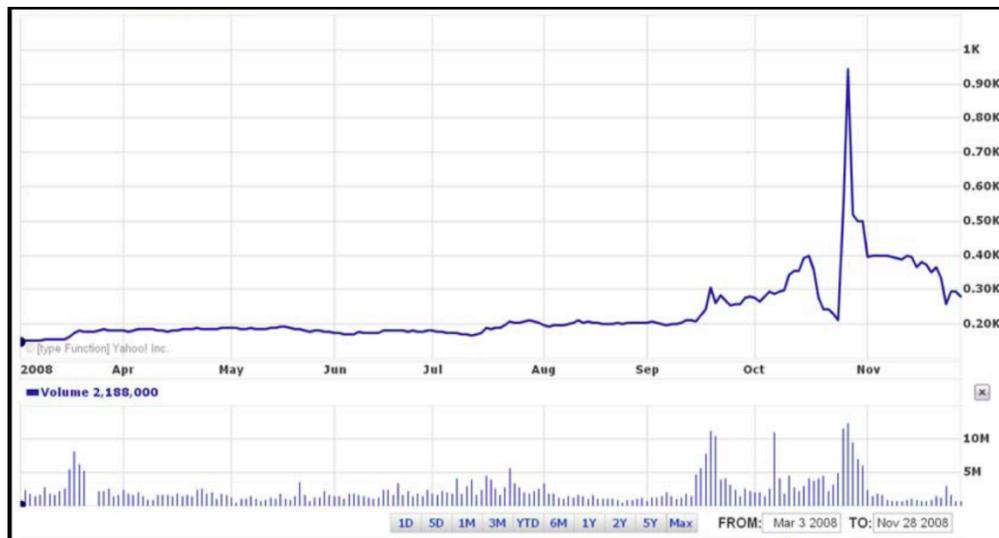
- "Identify any cases that have been dismissed as a result of *Morrison* or pending cases in which a challenge based on *Morrison* has been filed. Describe the facts of the case."
- "In *Morrison*, the Supreme Court held that in the case of securities that are not listed on an American stock exchange, Section 10(b) only reaches the use of a manipulative or deceptive device or contrivance in connection with the purchase or sale of a security in the United States. Address the criteria for determining where a purchase or sale can be said to take place in various transnational securities transactions."

Dismissal of *Elliott Assocs. v. Porsche Automobil Holding SE*, 2010 U.S. Dist. LEXIS 138399, 10 Civ. 0532 (HB) (S.D.N.Y. Dec. 30, 2010).

In *Morrison v. National Australia Bank*, the Supreme Court limited the protection of § 10(b) to "transactions in securities listed on domestic exchanges, and domestic transactions in other securities." 130 S. Ct. at 2884. The Supreme Court held that

§ 10(b) of the Securities Exchange Act of 1934 reaches only transactions in securities that occur within the territorial United States. Limiting the protections of § 10(b) to transacting that occurs within the territorial United States gives force to the canonical presumption against extraterritorial application of American law. *Id.* at 2780. By its terms, § 10(b) applies equally to securities and securities-based swap agreements. Therefore, § 10(b) reaches securities-based swap agreements transacted within the territorial United States.

Our case, *Elliott Assocs. v. Porsche Automobil Holding SE*, involves securities-based swap agreements. The plaintiffs suffered over \$2 billion in losses when defendant Porsche Automobil Holding SE (“Porsche”) triggered what the financial press called “a massive short squeeze” (Reuters) and “a short squeeze of historic proportions” (New York Times). The short squeeze resulted when Porsche revealed what it long had hidden from the market: Porsche had cornered the market in the ordinary shares of Volkswagen AG (“VW Shares”) and intended to use its corner to take total control of Volkswagen AG. The following chart illustrates that Porsche’s short squeeze resulted in a sharp spike in the price of VW Shares:



The plaintiffs sued Porsche for securities fraud and manipulation before *Morrison* was decided. In the wake of *Morrison*, certain plaintiffs pleaded in an amended complaint that they transacted securities-based swap agreements within the territorial jurisdiction of the United States. Those securities-based swap agreements referenced the price of VW Shares traded on foreign exchanges. The

District Court dismissed those plaintiffs' § 10(b) claims. *See Elliott Assocs. v. Porsche Automobil Holding SE*, 2010 U.S. Dist. LEXIS 138399, 10 Civ. 0532 (HB) (S.D.N.Y. Dec. 30, 2010) (Baer, J.).

The District Court did not reject plaintiffs' allegations that they transacted securities-based swap agreements within the territorial jurisdiction of the United States. Instead, the District Court concluded that plaintiffs' transactions were the "functional equivalent" of transactions on a foreign exchange. In essence, the District Court carved out an exception to *Morrison's* transactional test, excluding from § 10(b)'s protections any transaction within the territorial United States that is the "functional equivalent" of a foreign transaction.

The physical location of one or both of the transacting parties should determine the availability of § 10(b) protection for off-exchange transactions, including securities-based swap agreements.

The District Court's carve-out profoundly misreads *Morrison* and ignores the American interest in policing transactions within its borders. *Morrison* draws a bright line around the territory of the United States. If there is transacting in securities or securities-based swaps within the territorial United States, then § 10(b) has application. If there is no transacting in securities or securities-based swaps within the territorial United States, then § 10(b) has no application.

The District Court's carve-out dramatically restricts the protections of § 10(b) beyond any plain reading of *Morrison*. The District Court's carve-out would, for example, exclude off-exchange purchasers and sellers of American Depository Receipts ("ADRs) from the protection of § 10(b), because those purchases and sales are the "functional equivalent" of purchases and sales of the stock on a foreign exchange.

Taken literally, the District Court's carve-out also would deny recourse to any investor who is defrauded in the off-exchange purchase or sale of a physical foreign security in the territorial United States, since such an off-exchange purchase or sale is the "functional equivalent" of a trade on a foreign exchange. For example, one could sell to a large number of investors, off-exchange, and within the territorial United States, physical share certificates for securities listed on the Caracas Stock Exchange (Bolsa de Valores de Caracas), using the most egregious lies one could think of to close the sales. Nevertheless, the defrauded investors would be without recourse under § 10(b) because their purchases would be the "functional equivalent" of purchases on the Bolsa de Valores de Caracas. This not only denies the private

litigants a right to recovery, it may create serious gaps in the Commission's powers as well.

If off-exchange transactions in ADRs, share certificates, or securities-based swap agreements are the "functional equivalent" of transactions on a foreign exchange such that there is no private right of action, then the Commission's authority to police such transactions must derive from the new powers given to it under 15 U.S.C. § 78aa(b)(1) and (2).

As to 15 U.S.C. § 78aa(b)(1)—the reinstated "conduct" test—the Commission may have difficulty establishing that the domestic transactions constitute "significant steps in furtherance of the violation" if they are deemed to be the "functional equivalent" of foreign transactions. Similar concerns arise under 15 U.S.C. § 78aa(b)(2)—the reinstated "effects" test.

We urge the Commission to clarify that off-exchange ADR, share certificate, or securities-based swap agreement transactions occur "in the United States" under *Morrison* when at least one side of the "transaction" occurs in the United States.* That is, the location of transactions is a pure, geographically based inquiry in which questions of "functional equivalence" have no place.

We thank you for your consideration, and would be pleased to discuss our position further with you or the appropriate staff members.

Sincerely,


James B. Heaton, III

* Note that courts cannot logically require that *both* parties be in the same location to determine the location of a transaction. A contrary rule would mean, for example, that a securities-based swap agreement with one party in the United States and the other party in London would be located neither place: not in the United States because of the counterparty in London, and not in London because of the counterparty in the United States. For regulatory purposes, it is possible for a transaction to occur in two places, but not in no place at all.