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SECOND CIRCUIT REVIEW

Expert Analysis

The Second Circuit and Extraterritoriality Analysis

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The U.S. Court of Appeals for the Second Circuit recently held that the Commodity Exchange Act (CEA) does not apply to certain futures contracts tied to two foreign currency benchmark rates known as Yen-LIBOR and Euroyen TIBOR. See *Laydon v. Coöperatieve Rabobank U.A.*, 2022 WL 17491341 (2d Cir. Oct. 18, 2022), amended (2d Cir. Dec. 8, 2022). In that decision, Circuit Judges Michael H. Park, Rosemary S. Pooler, and Eunice Lee unanimously concluded that the claims asserted by a plaintiff who traded on a U.S.-based exchange were nevertheless impermissibly extraterritorial because they were based on "predominantly foreign conduct," i.e., the bank defendants' allegedly fraudulent submissions to the foreign organizations that set the relevant benchmark rates.

The opinion was an extension of circuit precedents holding that a domestic transaction is necessary but not sufficient for a permissible domestic application of §10(b) of the Securities Exchange Act and the CEA. See *Parkcentral Glob. Hub Ltd. v. Porsche Auto. Holdings SE*, 763 F.3d 198, 216 (2d Cir. 2014); *Prime Int'l Trading, Ltd. v. BP P.L.C.*, 937 F.3d 94, 106 (2d Cir. 2019). At the same time, it reaffirmed an enduring conflict with the Ninth and First Circuits, which have rejected *Parkcentral* and adopted a bright-line transaction-based rule to determine the location of a §10(b) claim. See *Stoyas v. Toshiba*, 896 F.3d 933 (9th Cir. 2018); *SEC v. Morrone,* 997 F.3d 52 (1st Cir. 2021).

Background and District Court Proceedings

The appellant, Mr. Laydon, traded Euroyen TIBOR futures contracts in a Chicago exchange. Euroyen TIBOR is the rate at which banks can lend Japanese Yen outside Japan, as calculated from submissions by Tokyo banks, and it is affected by a second benchmark rate, Yen LIBOR, which is calculated by the British Bankers Association (BBA) based on submissions from banks in London. Laydon sued certain BBA panel banks and derivatives brokers on the theory that they had conspired to manipulate the price of Yen LIBOR and ultimately distorted the value of his futures contracts. Laydon asserted antitrust and CEA claims, all of which were dismissed, and unsuccessfully sought leave to add RICO claims. As most relevant here, the district court dismissed Laydon's last-surviving CEA claims on the grounds that they were impermissibly extraterritorial because the

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"wrongful conduct … is almost entirely foreign." *Laydon v. Mizuho Bank, Ltd.*, 2020 WL 5077186, at *2 (S.D.N.Y. Aug. 27, 2020). Laydon appealed.

The Presumption Against Territoriality In the Second Circuit

For decades, the Second Circuit applied a multi-factor "conduct-and-effects test" to assess whether transnational frauds were subject to the Securities Exchange Act. At the first step, U.S. law applied if the wrongful conduct took place in the United States. See, e.g., *S.E.C. v. Berger*, 322 F.3d 187, 193 (2d Cir. 2003). But if the key activities that harmed investors were abroad, the court applied a fact-specific, proximate-cause analysis to determine if the "predominantly foreign transaction had substantial effects within the United States." See, e.g., *Consol. Gold Fields PLC v. Minorco, S.A.*, 871 F.2d 252, 261 (2d Cir.), amended, 890 F.2d 569 (2d Cir. 1989).

The Supreme Court eventually rejected the "conduct-and-effects test" as difficult to administer and yielding unpredictable results, and instead instituted a new two-step framework. *Morrison v. Nat'l Aus. Bank, Ltd.*, 561 U.S. 247, 257-60, 269 (2010). Under the first step, the court asks whether Congress wrote the statute to apply extraterritorially, which requires finding a clear indication of congressional intent. Id. at 265. If the statute is not written to be extraterritorial, under the second step, the court examines whether the conduct relevant to the statute's "focus" occurred in the United States. Id. at 266. If the answer is yes, "then the case involves a permissible domestic application even if other conduct occurred abroad." *RJR Nabisco v. Eur. Cmty.*, 579 U.S. 325, 326 (2016).

With respect to §10(b), *Morrison* held that its "focus" was on protecting domestic exchanges and transactions and thus centered the territoriality inquiry on the location of the securities transactions and not the location of the fraud. Id. at 266-67. Soon after, the Second Circuit clarified that the *Morrison* test does not require that defendants "engage in conduct in the United States" so long as there is a domestic transaction. *Absolute Activist Value Master Fund Ltd. v. Ficeto*, 677 F.3d 60, 69 (2d Cir. 2012).

> The claims asserted by a plaintiff who traded on a U.S.-based exchange were nevertheless impermissibly extraterritorial because they were based on "predominantly foreign conduct," i.e., the bank defendants' allegedly fraudulent submissions to the foreign organizations that set the relevant benchmark rates.

Despite that, only two years later, the Second Circuit held in *Parkcentral* that, while a "domestic transaction" is necessary under *Morrison*, "such a transaction is not alone sufficient to state a properly domestic claim" under §10(b). See 763 F.3d at 215. Instead, the court called for a fact-intensive, case-by-case inquiry into whether a claim was "so predominantly foreign" that "Congress could not have intended" to permit it. Id. at 216. By pivoting to a multi-factorial analysis of conduct and effects rather than following a bright-line rule based on transaction location, the Second Circuit appeared to be harkening back to pre-*Morrison* jurisprudence without saying so.

More recently, in *Prime*, the Second Circuit extended the *Parkcentral* rule to CEA claims in a case that concerned futures contracts traded in New York that were pegged to the price of a foreign commodity, Brent crude oil. The court reasoned that the "focus" of the CEA's substantive provisions was not on transactions and exchanges, as was the case for §10(b), but on manipulative conduct. *Prime*, 937 F.3d at 107. But compare 15 U.S.C. §78j (Exchange Act discussing fraud "in connection with" securities), with, e.g., 7 U.S.C. §§6(c)(1), 9(a)(2) (CEA discussing manipulation "in connection with," or involving the price of, futures contracts "on or subject to the rules of any registered entities," i.e., commodities exchanges). And because the underlying manipulative conduct involved spot-price submissions to a London agency that in turn relied on fraudulent foreign transactions in the physical Brent crude oil market, the Second Circuit con-

cluded that the challenged claims were "predominantly foreign" and impermissibly extraterritorial. 937 F.3d at 106, 107-08.

The Second Circuit's Opinion on Extraterritoriality in 'Laydon'

In the relevant part of an opinion authored by Circuit Judge Park—joined in full by Senior Circuit Judge Pooler and Circuit Judge Lee—the Second Circuit held that *Prime* "mandates dismissal of [Laydon's] CEA claims" because they are "predominantly foreign." First, the court noted that Laydon traded a derivative "tied to the value of a foreign asset" that was "based on rates set by foreign entities … in foreign countries." 2022 WL 17491341, at *5. Second, the court looked once more to the location that *Morrison* had held did not matter for the territoriality of §10(b) claims: where the "alleged manipulative conduct occurred," which was abroad. Id. By analogy to *Prime*, the court explained that defendants had allegedly "conspired to manipulate Euroyen TIBOR (an index tied to a foreign market) by giving false Yen-LIBOR submissions to the BBA from foreign trading desks (conduct abroad)." Id. The court did not address whether direct manipulation of an interest-rate index should be treated differently from manipulation of a "physical market," as in *Prime*, because the former arguably has a stronger nexus to the pricing of futures contracts trading on domestic exchanges than to the pricing of an underlying tangible commodity trading abroad.

The court's gloss over the index-versus-physical market distinction is also significant because, in its original October 2022 opinion, the court concluded that Yen-LIBOR and Euroyen TIBOR were not "commodities" traded on a domestic exchange under the CEA. ECF No. 362-1 at 15-17. In an amicus brief supporting rehearing, the U.S. Commodity Futures Trading Commission (CFTC) urged the court to reconsider that portion of its opinion, warning that it created yet another circuit split with the Seventh Circuit and also called into question whether the CEA prohibited fraud and manipulation of all rates, indexes, and other intangible measures underlying derivatives contracts. ECF No. 383. On Dec. 8, 2022, the court amended its original opinion to remove the discussion of Yen LIBOR and Euroyen TIBOR's status as commodities, impliedly agreeing with the CFTC's position. But it did not alter its conclusion that the manipulation of "an index tied to a foreign market" such as Euroyen TIBOR was still predominantly foreign conduct despite its foreseeable, and intended, effects on futures trading on domestic exchanges.

The Second Circuit's decision in 'Laydon v. Coöperatieve Rabobank U.A.' continues a trend towards construing the "focus" of the CEA as conduct-based despite textual similarities with the Exchange Act whose focus is on exchanges and transactions.

Conclusion

The Second Circuit's decision in *Laydon v. Coöperatieve Rabobank U.A.* continues a trend towards construing the "focus" of the CEA as conduct-based despite textual similarities with the Exchange Act whose focus is on exchanges and transactions. This makes it more likely that schemes organized abroad that target commodities exchanges in the United States will be deemed impermissibly extraterritorial. The Ninth and First Circuits have already rejected the Second Circuit's approach to extraterritoriality for §10(b) claims and also called into question whether it is consistent with Supreme Court precedent. It remains to be seen whether the Supreme Court will weigh in on this split, but so far it has denied certiorari. In the meantime, under *Parkcentral*, *Prime*, and now *Laydon*, the Second Circuit appears to have revived the "conduct-and-effects" test, albeit under a different name.