

The Territorial Barrier to Commodity Exchange Act Suits

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While judicial ink has long been spilled on the extraterritoriality of the securities laws, growing attention is being paid to the overseas reach of the antifraud provisions of the Commodity Exchange Act (CEA). In September, a divided panel of the U.S. Court of Appeals for the Second Circuit addressed the law's extraterritoriality in *Loginovskaya v. Batratchenko*, with potentially far-reaching implications for private actions and government enforcement under the CEA, and perhaps other statutory schemes as well.

Ludmila Loginovskaya, a Russian citizen living in Russia, invested with the Thor Group, which in turn manages investments in commodity futures and real estate. Although Loginovskaya initially received account statements showing positive returns, the Thor Group allegedly drained her accounts and failed to return her money upon request. Loginovskaya brought a private action in the Southern District of New York, alleging that the Thor Group (together with its various executives and affiliates, whom we will collectively call Thor) violated the CEA by making fraudulent misrepresentations.

Thor moved to dismiss Loginovskaya's claims on extraterritoriality grounds, arguing that her investment contracts were negotiated and signed in Russia, and thus were outside the CEA's reach. Loginovskaya, meanwhile, relied on various domestic aspects of Thor's alleged wrongdoing: one individual defendant was a U.S. citizen; several corporate defendants



were registered in the United States under the CEA as commodity pool operators or commodity trading advisers; Loginovskaya wired funds to Thor's offices in the United States; Thor allegedly invested in U.S. properties and entered some fraudulent real estate transactions within the United States; and Thor's allegedly fraudulent accounting statements were likewise created in the United States.

Judge J. Paul Oetken dismissed Loginovskaya's claims and a divided panel of the Second Circuit affirmed, holding that the complaint failed to allege a necessary commodities transaction within the United States. In doing so, the Second Circuit applied to the CEA—for the first time—the extraterritoriality framework announced by the Supreme Court in 2010 in *Morrison v. National Australia Bank Ltd.*

As a threshold matter, the majority opinion by Judge Dennis Jacobs, applying the *Morrison* framework, concluded

that no clear statement in the CEA—which “is silent as to extraterritorial reach”—had overridden the presumption against extraterritorial application of statutes. This conclusion alone does not, however, resolve most cases, including Loginovskaya's, because rarely is a fact pattern entirely extraterritorial. Therefore, as in *Morrison*, courts also must inquire into what aspects of a CEA claim anchor it to the United States—in other words, what “objects of the statute's solicitude” were the “focus of congressional concern” and therefore must be domestic in nature.

The majority found its answer in section 22 of the CEA, which grants a private plaintiff like Loginovskaya the right of action against a defendant whose violation of the CEA resulted from one or more of the specifically enumerated types of transactions. Because section 22 thus speaks in transactional terms, the Second Circuit concluded that

Morrison's extraterritoriality principles require private actions to "be based on transactions occurring in the territory of the United States." To satisfy this standard, a plaintiff must show either that title to the interest in the commodity pool was transferred within the United States; or that the purchaser (or seller) incurred irrevocable liability to take and pay for (or to deliver) the interest in the commodity pool within the United States.

By requiring a domestic transaction in a private action, the Second Circuit landed in the same place the Supreme Court did in the context of the securities antifraud provision in *Morrison*, interpreting section 10(b) of the Securities Exchange Act of 1934 to require a securities transaction within the United States or in a security listed on a domestic exchange.

Applying this framework to Loginovskaya's allegations, the majority found them insufficient. Loginovskaya resided in Russia, was solicited for her investment in Russia, negotiated the relevant contracts in Russia and signed them in Russia. Accordingly, the point of "irrevocable liability" occurred abroad, and no amount of subsequent fraudulent conduct could cure Loginovskaya's failure to plead a requisite domestic transaction.

Judge Raymond Lohier Jr. dissented, reasoning that the presumption against extraterritoriality should apply to the substantive federal laws that define proscribed conduct, not to procedural provisions (like section 22) that define the scope of private causes of action. And the substantive antifraud provision at issue in Loginovskaya's case—section 40 of the CEA, which prohibits commodity trading advisers from employing any device, scheme or artifice to defraud any client or participant—appears to focus on commodities market participants and their practices, not on transactions by individual investors. Lohier therefore would have deemed Loginovskaya's allegations about Thor's misconduct in the United States sufficient to state a CEA claim.

IMPLICATIONS FOR ENFORCEMENT

While *Loginovskaya* appears to close the door to some private CEA litigation, the Commodity Futures Trading Commission

should be expected to contend that its enforcement activities are not similarly constrained. In narrowing the extraterritorial application of section 22, which governs private rights of action, the Second Circuit left untouched the general antifraud provisions of section 40, as well as the other prohibitions in the CEA, such as the relatively broad section 6(c), which has both antifraud and anti-manipulation aspects, and the false report provision in section 9(a).

Both of these provisions, like section 40 (and unlike the securities law section 10(b)), do not require a transaction. Indeed, none of three members of the divided Second Circuit panel disputed that an enforcement action based on a violation of section 40 might succeed on the same facts alleged by Loginovskaya, even without a domestic transaction. While Lohier expressly endorsed this conclusion, the majority acknowledged it with a discrete double negative: "The contention that Morrison's transaction test is inapplicable to § 40's antifraud protection is not without merit."

Accordingly, the commission may argue that it can enforce the CEA on the very facts that doomed Loginovskaya's claim. This did not trouble the majority, which reasoned that private litigation and government enforcement commonly have different scope—and found no reason to disfavor a statutory interpretation that leads to this asymmetry. (Similarly, in his concurring opinion in *Morrison*, Justice John Paul Stevens noted that limitations on private extraterritorial claims did "not foreclose the [Securities and Exchange] Commission from bringing enforcement actions in additional circumstances, as no issue concerning the Commission's authority" was precluded by *Morrison*.)

Arguably, the gap in civil actions created by the Second Circuit's decision may even have the unintended effect of inviting more assertive enforcement efforts by the commission. On the other hand, the Second Circuit did not squarely resolve the issue, so a future defendant facing an enforcement action on similar facts can still be expected to challenge it on extraterritoriality grounds, relying on the principles of *Morrison* and on the absence of clear statutory language applying the CEA's

prohibitions extraterritorially.

Notably, these developments are occurring at a particularly propitious time for the commission's cross-border activities: The agency recently succeeded in defending, before the District Court for the District of Columbia, its Dodd-Frank rules authorizing the extraterritorial regulation of derivatives having "direct and significant connection with activities in, or effect on, commerce of the United States."

We therefore anticipate *Loginovskaya* and similar decisions to continue posing obstacles to private CEA suits, but it remains to be seen whether they will interfere with Commodity Futures Trading Commission enforcement abroad of the CEA's antifraud and anti-manipulation provisions.

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