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The Second Circuit Speaks: The Presumption Against Extraterritoriality Applies to Criminal Prosecutions

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Last Friday, the Second Circuit held that the presumption against extraterritoriality applies to criminal cases, resolving a key question left open by the United States Supreme Court in *Morrison v. National Australia Bank*,[1] and sharply restricting the ability of United States criminal authorities to prosecute individuals and companies for conduct outside the United States. The opinion, issued in *United States v. Vilar*,[2] closes one possible avenue for prosecution of foreign individuals and companies, but leaves open many questions in its wake.

MORRISON AND ITS LEGACY

In 2010, the Supreme Court in *Morrison* held that the plaintiffs in a private securities suit could not bring claims under Section 10(b) of the Securities Exchange Act because the purchase of the relevant security did not take place on a United States exchange or otherwise qualify as a domestic transaction. Underlying the decision was the Supreme Court's reasoning that statutes enjoy a presumption against extraterritoriality, which can be rebutted only by a clear demonstration of Congressional intent. Because Section 10(b) did not clearly apply extraterritorially, it could not be invoked by the plaintiffs to pursue claims arising from foreign transactions.

Morrison left open, however, the question of whether the Securities & Exchange Commission or Department of Justice ("DOJ") could bring, respectively, civil enforcement actions or criminal prosecutions against individuals or companies for violating the securities laws where such a prosecution would involve extraterritorial application of Section 10(b).

In light of this uncertainty, criminal defendants have invoked *Morrison* as a bar to prosecution, but have done so without a clear map as to how a court might rule. DOJ has responded with a host of rebuttals, including (1) that *Morrison* does not apply to criminal cases so there is no presumption against extraterritoriality to thwart prosecution, (2) that the underlying statute applies extraterritorially in any event, and (3) that the DOJ need not apply a statute extraterritorially to reach the particular defendant because of conduct or effects in the United States.

THE *VILAR* COURT CLOSES A DOOR TO PROSECUTION

The *Vilar* court noted that "there has been no shortage of questions raised in [*Morrison*'s] wake," and proceeded to resolve one of those questions in favor of individuals or companies facing prosecution.[3] In that case, DOJ had

[1] 130 S. Ct. 2869 (2010).

[2] Case No. 10-521, 2013 WL 4608948 (2d Cir. Aug. 30, 2013).

[3] *Id.* at *5.

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charged former investment advisor – and well known opera philanthropist – Alberto Vilar with 12 counts of fraud arising from his alleged perpetration of a scheme involving Guaranteed Fixed Rate Deposit Accounts ("GFRDA"). DOJ alleged that Vilar and his co-defendant, Gary Tanaka, had solicited investments into a risky technology investment account. When that account's value dwindled in the aftermath of the tech bubble bursting, Vilar and Tanaka allegedly sought investments in an un-licensed Small Business Investment Company account, but used those funds to cover personal expenses and to pay settlements to unsatisfied GFRDA investors. Ever the philanthropist, Vilar also used some of the investment proceeds to make donations to his alma mater.[4] Vilar and Tanaka were convicted at trial and appealed.

On appeal, Vilar and Tanaka argued, among other things, that *Morrison* prevented DOJ from prosecuting them for securities fraud where, under *Morrison*, Section 10(b) did not apply extraterritorially to reach the foreign securities transactions at issue. In response to DOJ's arguments to the contrary, the *Vilar* court held that it had "no problem concluding that *Morrison*'s holding applies equally to criminal actions brought under Section 10(b)" and adding that such a result was "clear or obvious" for purposes of its review.[5] As a result, DOJ now has one fewer avenue for responding to claims that *Morrison* prevents prosecution of criminal offenses in the Second Circuit. Under *Vilar,* DOJ can now prosecute foreign conduct only by showing (1) that the relevant statute applies extraterritorially or (2) that the underlying conduct was sufficiently related to the United States that prosecution constitutes domestic application of the statute.

QUESTIONS REMAIN AFTER *VILAR*

The *Vilar* holding will have ramifications outside the context of Section 10(b), shifting the debate for application of other criminal statutes in cases with a foreign component. First, *Vilar* leaves open whether statutes other than Section 10(b) would apply extraterritorially.[6] In other words, it is not clear how the Second Circuit might have resolved extraterritoriality challenges by Vilar resulting from his wire fraud, mail fraud, or money laundering convictions, because those issues were not raised in the instant appeal.

Second, there is likely to be disagreement as to whether such statutes were intended to apply extraterritorially, as well as a substantial debate concerning the nature and degree of contacts with the United States necessary to give rise to domestic application of a statute. While *Vilar* signals a high burden for DOJ in showing that conduct was domestic for the purpose of the *Morrison* analysis, it does not set forth a comprehensive analysis for determining whether conduct is extraterritorial outside of the Section 10(b) framework. Specifically, the *Vilar* court held that the share purchases at issue were domestic because the victims "incurred irrevocable liability in the United States" and therefore prosecution of Vilar and Tanaka did not require extraterritorial application of Section 10(b). The court noted, however, that other connections to the United States – including transmission of funds over U.S. wires, marketing to customers in the U.S., or using a U.S. firm as a custodian – would not have sufficed to render application of Section 10(b) domestic as to Vilar and Tanaka.[7] Under the *Vilar* court's analysis, therefore, substantial connections to the United States do not automatically permit domestic application of criminal statutes, and a statute by statute analysis is necessary to evaluate whether extraterritorial application is

[4] *Id.* at 4.

[5] *Id.*

[6] *Id.* at *8.

[7] *Id.* at *9 n. 10.

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required in criminal cases. These issues will be particularly thorny in the increasingly global financial markets, where purportedly criminal conduct outside the United States may have effects on persons or entities worldwide, including in the United States.

Finally, in a short footnote at the end of the opinion, the court noted that the same panel would hear any motions for bail pending an appeal to the Supreme Court, indicating the court's immediate recognition that even its current reasoning would be challenged, and its holding may not be the last word on the extraterritorial reach of criminal prosecutions.[8]

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[8] *Id.* at *27.

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