Swindled Foreign Investors Not Protected by U.S. Fraud Law

By Teresa Rider Bult, Litigation News Associate Editor – March 9, 2015

Victims of an alleged Russian investment fraud scheme cannot bring suit in U.S. federal court under the Commodity Exchange Act (CEA) because the statute only covers domestic transactions and not extraterritorial ones. In Loginovskaya v. Batratchenko, et al. In reaching that conclusion, the U.S. Court of Appeals for the Second Circuit applied a presumption against the extraterritorial effect of the statute and dismissed the complaint, finding that the alleged fraud occurred outside the United States. Observers disagree on the proper application of the presumption, raising the question of whether other circuits will similarly follow.

Plaintiff Alleges Funds are Swindled in Russia and Wired to New York
In Loginovskaya, a Russian plaintiff invested over $700,000 with an investment company based in New York. Although the investment contracts were solicited and signed by the parties in Russia, the funds were wired to a bank in New York and the defendants were located in the United States.

After Loginovskaya's funds had been allegedly swindled, she brought suit in the U.S. District Court for the Southern District of New York against the investment company and its CEO, alleging fraud claims under the CEA pursuant to 7 U.S.C. § 6(o). This section of the statute prohibits any commodity trading advisor from engaging in practices that would have the effect of defrauding investors. While primarily administrative, section 25 of the statute permits a private right of action under limited circumstances. Upon consideration of the defendants’ 12(b)(6) motion, the district court dismissed the case, finding that the CEA requires proof of a domestic (U.S. based) transaction, and no such transaction was pled.

Second Circuit Applies Presumption Against Extraterritoriality
On appeal, the Second Circuit first analyzed whether the CEA limits claims to transactions occurring within the United States since the CEA is silent as to its extraterritorial reach. The appellate court relied upon the Supreme Court’s decision in Morrison v. National Australia Bank Ltd., et al., which held that the Securities Exchange Act (SEA), also silent as to territorial limits, prohibited foreign transactions. The Morrison court rejected prior tests for determining if a statute allowed extraterritorial reach and instead created the “extraterritorial presumption,“ which states “unless there is the affirmative intention of the Congress ‘clearly expressed’ to give a statute extraterritorial effect, we must presume it is primarily concerned with domestic conditions.”

The Second Circuit went on to find that this presumption also applied to the CEA because it is similarly silent as to its territorial reach. Thus, for her case to proceed, the Loginovskaya plaintiff was required to plead and prove that a transaction occurred within the United States. The appellate court found she had not done so and could not make such a showing, because the only “transaction” which had arguably occurred was the wiring of funds to a New York bank account. The Second Circuit upheld the district court’s dismissal, reasoning that the wiring of the funds was not the core “meeting of the minds” transaction between the parties in this case, but was instead an “action required to carry out” the original foreign transaction.

Russian Plaintiff “Never Had a Chance”
Some Section leaders are troubled by the opinion, agreeing with the dissent that the plaintiff “never had a chance.” “I have difficulty understanding how the court treats this as a remedial statute with this result,” says Theodore G. Fletcher, Southwest Harbor, ME, cochair of the International Issues Subcommittee of the ABA Section of Litigation’s Criminal Litigation Committee. It was a “stretch to apply Morrison,” he adds. Fletcher agrees with the dissent’s assessment that the extraterritoriality rule should not apply to statutes that do not regulate conduct.

Conversely, Stephen J. Siegel, Chicago, IL, cochair of the Section of Litigation’s Commercial & Business Litigation Committee, believes the Second Circuit appropriately extended the presumption to the CEA. “In the absence of a statute’s clear intent to regulate transactions made outside the United States, Morrison seems to make clear that the presumption against extraterritorial effect should be applied to defeat a claim arising out of transactions made outside the United States.”
abroad," he says.

Both Fletcher and Siegel agree, however, that once it got to the "domestic transaction" question, the court appropriately found that such a transaction had not occurred, simply because some act must necessarily occur in the United States. "The really interesting question might be whether this question of domestic transaction creates a jury question for the fact finder or if it is purely jurisdictional and left as a legal question for the bench," observes Fletcher.

To avoid the same 12(b)(6) fate as this plaintiff, Siegel advises, "attorneys representing foreign clients who wish to bring CEA claims in federal court should plead, in a specific and thorough manner, how the disputed transaction was made in the United States—in particular, how title passed in the United States or the parties incurred 'irrevocable liability' within the United States." Fletcher notes that such particularity is "almost impossible to do pre-discovery" and may have required proof that the plaintiff wrote the check in New York or some such direct fact.

**Keywords:** fraud, investors, jurisdiction, Commodity Exchange Act

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**Related Resources**

- 7 U.S.C. § 1 et seq.