

ClientAlert

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Supreme Court to Move on F-Cubed Securities Cases: High Court to Consider Reach of US Securities Laws as to Non-US Issuers



Executive Summary

As securities markets and global finance have expanded, securities litigation increasingly has involved claims in US courts (1) by non-US purchasers; (2) who bought or sold securities from non-US issuers; (3) on non-US exchanges (so-called “f-cubed” claims). Developments in two pending f-cubed cases highlight the difficult issues with which US courts continue to struggle. Non-US companies should watch both cases closely given the risks associated with the US securities laws and US class action litigation generally.

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Developments in Transnational Securities Fraud Litigation: US Courts Continue to Wrestle with Issues Relating to Non-US Issuers

In *Morrison v. National Australia Bank Ltd.*,¹ the US Supreme Court recently decided to review the reach of the US securities laws in the f-cubed context. In *In re Vivendi Universal, SA Sec. Litig.*,² trial is under way in an f-cubed case in which the court certified a predominantly non-US class of claimants.

Morrison Analysis and Developments

Morrison involved a putative class of non-US plaintiffs who had invested in the common stock of an Australian bank that was not traded on a US exchange. The bank, however, had US-listed ADRs and prepared and filed disclosure materials with the SEC. The bank owned a large mortgage service provider in Florida. It was alleged that this Florida subsidiary was poorly managed and reported fraudulent financial information back to the bank. This information was incorporated into the Australian bank’s financial statements which were then, among other things, filed with the SEC.

¹ 547 F.3d 167 (2d Cir. 2008). The Second Circuit’s opinion in *Morrison* may be found at: http://www.lawupdates.com/pdf/postings/securities/Morrison,_et_al._v._National_Australia_Bank_Ltd.,_et_al..pdf.

² 381 F. Supp. 2d 158 (S.D.N.Y. 2003).

Second Circuit Ruling

The US Court of Appeals for the Second Circuit affirmed a lower court's dismissal of the case. While declining to adopt a bright-line rule that would place all f-cubed claims outside the subject matter scope of US securities law jurisdiction, the court applied the so-called conduct and effects tests and held that jurisdiction was lacking in the case.

Under the *conduct test*, US securities laws may reach cases where: (1) conduct material to the completion of the fraud occurred in the United States and (2) conduct within the United States directly caused the plaintiff's loss.³ The test focuses on whether the alleged fraud was completed or consummated in the United States. Conduct preparatory to the fraud and/or conduct causing harm to non-plaintiff parties in the United States would not support subject matter jurisdiction. Under the *effects test*, jurisdiction only would exist where a predominantly non-US transaction had substantial and direct effects within the United States. Again, preparatory conduct, as well as remote or indirect effects, would not support jurisdiction.⁴

In *Morrison*, the absence of any US investor-plaintiffs or claims as to US-traded securities ruled out jurisdiction under the effects test. Jurisdiction also was unavailable under the conduct test even though allegedly fraudulent information was created at the issuer's US subsidiary and then included in the Australian issuer's SEC filings for its US ADRs. The court determined that the "heart" of the fraud was in Australia where the issuer was located and where the bank's personnel prepared the issuer's public filings.⁵ Because the bank's conduct in Australia comprised the "heart of the fraud," no conduct within the United States directly caused the plaintiffs' injuries. The "lengthy chain" of causation between fraudulent figures from Florida (which were not conveyed directly to the market), and the use and dissemination of those figures by the bank in Australia, could not support the exercise of US jurisdiction.

Supreme Court Grants Certiorari

On November 30, 2009, the Supreme Court agreed to review the Second Circuit's decision notwithstanding the advice of the Solicitor General ("SG") and the SEC.⁶ The SG argued that the Second Circuit should not have adopted a "heart of the fraud" approach to the conduct test because the expansion and integration of global securities markets have made it less likely that any one jurisdiction would encompass the "heart" of the fraud.⁷ Rather, the protection of the securities laws should extend to any case that "involves significant conduct within the United States that is material to the fraud's success."⁸ When evaluated according to this standard, the plaintiffs' complaint sufficiently alleged a violation of the securities laws. However, the SG asserted that a private cause of action based on the securities laws should not be allowed to proceed without proof that the plaintiffs' loss "resulted not simply from the fraudulent scheme as a whole, but directly from the component of the scheme that occurred in the United States."⁹ The SG argued that the link between the Florida subsidiary's conduct and the ultimate harm to the plaintiffs was too indirect to support a private lawsuit.¹⁰

The SG also argued that the Supreme Court should not grant review because Congress was considering legislation that would affect the transnational scope of the antifraud provisions of the securities laws.¹¹ On December 11, the US House of Representatives passed H.R. 4173, which would provide for jurisdiction for a violation of the antifraud provisions of the securities laws involving: (1) "conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors" or (2) "conduct occurring outside the United States that has a foreseeable substantial effect within the United States."¹² A companion bill in the US Senate, however, remains in committee and does not yet include similar jurisdictional language.

3 See *North South Fin. Corp. v. Al-Turki*, 100 F.3d 1046, 1051 (2d Cir. 1996).

4 100 F.3d at 1051-52.

5 547 F.3d at 176.

6 Before the Second Circuit the SEC had argued that jurisdiction over the claim was proper. The SEC then changed course and joined the SG in opposing the plaintiffs' request for Supreme Court review. The brief jointly filed by the SEC and SG may be found at: <http://www.sec.gov/litigation/briefs/2009/morrison1009.pdf>.

7 Solicitor General's Brief at 12.

8 Solicitor General's Brief at 13.

9 *Id.* at 14.

10 *Id.* at 15-16. The SG also asserted that the Supreme Court should deny certiorari because no other appellate courts would have allowed the private suit to proceed.

11 *Id.* at 6, n. 1.

12 Wall Street Reform and Consumer Protection Act of 2009, H.R. 4173, §7216.

Among other things, *Morrison* may allow the Supreme Court to apply its recent jurisprudence on the importance of proximate and loss causation in securities fraud actions to the question of jurisdiction.¹³ For example, the SG argued that the location of a fraudulent scheme is irrelevant for purposes of subject matter jurisdiction. Rather, the location of the fraud is relevant for determining whether there is a direct causal link between plaintiffs' injury and any fraudulent conduct that occurred in the United States.¹⁴

Morrison shows how difficult it can be for plaintiffs to bring successful f-cubed claims in US courts, even if the issuer has a presence in the United States and ADRs traded on US exchanges. Given the Supreme Court's recent cases on causation and pleading in securities cases, *Morrison* will bear watching to see if the Supreme Court further limits the reach of private actions under US securities laws.

Vivendi Analysis and Developments

In *Vivendi*, the defendant French company is not registered to do business in the United States, but does have US-listed ADRs. Plaintiffs claim that key Vivendi officers came to the United States to conduct US asset purchases, which involved SEC filings, and to make statements which inflated the value of Vivendi shares which were then used to purchase the US assets. The plaintiff class includes shareholders from the US, UK, France and the Netherlands.

Subject Matter Jurisdiction Upheld

The New York federal district court held that it had subject matter jurisdiction over the case under the conduct test.¹⁵ As the court explained, the alleged US conduct was not "merely preparatory," but instead involved decisions by key Vivendi officers "to move to the United States, allegedly to better direct corporate operations and more effectively promote misleading perceptions" of Vivendi's share price. Thus, the alleged fraud on the US exchange was a "substantial" or "significant contributing cause" of the decision by non-US investors to purchase shares outside the United States.¹⁶

Class Certification Granted

In May 2007, the court also certified a class of potentially injured US and non-US investors.¹⁷ Even though only about 25 percent of Vivendi's shares were held in the US through the ADRs,¹⁸ the court determined that a US class action was the superior method to resolve the dispute (i.e., that under Federal Rule of Civil Procedure 23, on "balance, in terms of fairness and efficiency, the advantages of a class action [trumped] alternative available methods of adjudication").¹⁹

In so ruling, the court rejected Vivendi's arguments against class certification based on: (1) pending lawsuits by individual shareholders against Vivendi in French courts and (2) the potential refusal by non-US courts to recognize a US judgment for the class.

¹³ See *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007) (regarding proximate causation); *Dura Pharms., Inc. v. Broudo*, 544 US 336 (2005) (regarding loss causation).

¹⁴ *Id.* at 9-10.

¹⁵ 381 F. Supp. 2d at 169.

¹⁶ *Id.* at 169-70.

¹⁷ *In re Vivendi Universal, Sec. Litig.*, 242 F.R.D. 76 (S.D.N.Y. 2007).

¹⁸ *Id.* at 81.

¹⁹ 242 F.R.D. at 91.

The pending lawsuits were not a basis for denying certification because “individual shareholder[s who have] an interest in conducting separate law suits [are insufficient] to outweigh the advantages to all shareholders of proceeding on a class basis.”²⁰ The possibility that foreign courts might not recognize a US class action also did not prevent class certification because the risk of non-recognition was not uniform from nation to nation, and had to be evaluated “along a continuum...where plaintiffs are able to establish a probability that a foreign court will recognize” a US class action judgment.²¹ Foreign plaintiffs who cannot show that their domicile is more likely than not to recognize a US judgment would be excluded from the class. Applying this analysis, the court found that the UK, France and the Netherlands would be amenable to a US class action, while plaintiffs from Austria and Germany were excluded from the class because there was doubt that those nations would enforce a US class action judgment.²²

Trial is ongoing and may conclude before year end. This case, and any eventual appeal, will bear close scrutiny with respect to f-cubed issues.

Implications

Morrison and *Vivendi* underscore the continuing issues presented by f-cubed cases. Non-US companies should watch both cases closely given the risks associated with US securities laws and US class action litigation generally.

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²⁰ *Id.* at 92.

²¹ *Id.* at 95.

²² The court subsequently denied defendant’s motion to reconsider its ruling as to French investors based on alleged recent developments under French law, finding that France had not yet adopted a class action statute, and that no French court had addressed the constitutionality of any such statute. *See In re Vivendi Universal, SA Sec. Litig.*, No. 02 Civ.5571(RJA)(HBP), 2009 WL 855799 (S.D.N.Y. Mar. 31, 2009). The court noted a number of advantages to adjudicating claims in the United States, including that “second-bite” litigation would be discouraged because an adverse US decision based on full discovery unavailable in France would leave potential French plaintiffs with exposure for defendants’ legal fees (available under French law) if they were to sue again in France and lose. As such, the hypothetical risk of a less than complete binding US judgment did not diminish the superiority of the US class action.