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Foreign Bank Issuer. Foreign Plaintiff. Foreign Transaction. Class Action Exposure in the U.S. Under Federal Securities Laws?

JAMES F. MOYLE AND STEVEN L. PENARO

Recently, an ultra aggressive type of securities class action lawsuit has garnered significant attention from the legal and business communities. These so-called "f-cubed" cases involve: (1) a foreign purchaser; (2) suing a foreign issuer for violations of U.S. securities laws; (3) with respect to securities transactions in foreign countries. These lawsuits present substantial challenges for foreign public companies that are concerned with potential exposure to U.S.-style class actions, because they may require little nexus to the United States. The authors discuss "f-cubed" lawsuits, with an emphasis on a pending U.S. Supreme Court case which many hope will provide foreign banks and other corporations a better defined roadmap as to their potential exposure to litigation in the U.S.

Corporate officers and directors around the globe accept the fact that the U.S. is a litigious country where lawsuits are an entrenched part of doing business.[1] As quickly as prophylactic measures are adopted by lawmakers and companies to reduce the likelihood of vexatious litigation, entrepreneurial class action lawyers develop new strategies attempting to im-

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pose liability.

"F-CUBED" LAWSUITS

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The Securities Exchange Act, which contains the primary antifraud provision of the federal securities laws, does not directly address its application to foreign transactions. To assess whether jurisdiction exists, courts have adopted the "conduct and effects" test which examines (1) whether and to what extent the fraudulent conduct occurred in the U.S., and (2) whether it had a substantial effect in the U.S. Although analytically reasonable, this test requires a fact intensive inquiry and provides courts with little direction as to when particular "conduct and effects" are sufficient to confer jurisdiction. With no bright line rule, this circumstantial test has been applied with inconsistent and unpredictable results. That may soon change.

MORRISON v. NATIONAL AUSTRALIA BANK LTD.

The U.S. Supreme Court recently heard arguments in an f-cubed case where defendants and other interested parties argued in favor of a bright line test that would prohibit such suits. In *Morrison v. National Australia Bank Ltd.*,[2] foreign plaintiffs invested in the ordinary shares of Australia's largest bank, which were traded on several exchanges — all outside the U.S. The bank owned a large mortgage service provider in Florida, which allegedly reported false financial information back to the Australian bank. This information was incorporated into the bank's financial statements which were filed with the SEC, inserted into annual reports, and disseminated by bank personnel in Australia via public filings and statements. Later, the bank revealed it was taking millions of dollars in writedowns because certain assumptions in the Florida service provider's valuation model resulted in overstatements in the bank's financials. This news caused the bank's ordinary shares to decline significantly and plaintiffs' lawsuit followed, alleging that the Florida subsidiary falsified information which rendered the bank's financials false and misleading in violation of the Exchange Act.

On the bank's motion, the District Court dismissed the case holding that it lacked jurisdiction over the claims. On appeal, the Second Circuit recognized as fundamental the issue whether "Congress would have wished the precious resources of the United States courts and law enforcement agencies to be devoted to such [extraterritorial] actions."[3] In its analysis, the court applied the long standing "conducts and effects test" to assess whether the harm was perpetrated in the U.S. or abroad, and whether it substantially affected U.S. markets and investors. Under this test, "subject matter jurisdiction exists if activities in this country were more than merely preparatory to a fraud and culpable acts or omissions occurring here directly caused losses to investors abroad."[4]

Making these determinations was, the court acknowledged, a difficult and fact intensive process. For this reason, defendants and other interested parties encouraged the Second Circuit to adopt a bright line rule prohibiting f-cubed cases where the conduct had no effect in the U.S. The Second Circuit, however, declined to do so, stating that to automatically bar jurisdiction in such cases "would conflict with the goal of preventing the export of fraud from America."[5] Nonetheless, the court affirmed the dismissal, finding that the locus of the fraud was in Australia, where the bank (and not the subsidiary) had primary responsibility for the accuracy of its public filings, and where the allegedly misleading shareholder reports were actually disseminated. Although the issue was not before the court on appeal, the Second Circuit also noted the absence of allegations that the alleged fraud affected U.S. markets or investors.[6]

On November 30, 2009, the Supreme Court agreed to hear the case and oral arguments were held on March 29, 2010. Defendants and other interested entities (such as the United Kingdom, France, and Australia) argued that jurisdiction is improper because, among other things, it intrudes on the laws of sovereign nations with a more acute interest in the result. For example, a "friend of the court" brief submitted by the Republic of France asserted that subjecting French defendants to the jurisdiction of the U.S. courts and U.S. securities laws would disrupt the regulatory scheme of France and the expectations of issuers who availed themselves of that nation's markets. Similarly, the United Kingdom noted that "nations have a strong interest in regulating their own capital markets, developing disclosure rules to govern their own issuers, deciding how and when class action litigation should occur and determining the penalties for violations of such laws."[7] Extraterritorial application of the Exchange Act, they argued, goes against well established principles of comity and may impede open capital markets. They, too, encouraged the imposition of a bright line rule prohibiting f-cubed suits. Plaintiffs, meanwhile, argued that the Second Circuit gave insufficient weight to the fact that the financials allegedly were manipulated in Florida. And as to comity issues, plaintiffs claimed that Congress did not intend to allow the U.S. to be used as a base for manufacturing fraud, even when the fraud only affects foreigners.

At oral argument, the Justices expressed uneasiness that U.S. courts would exercise jurisdiction in such cases. Justice Alito, for example, asked plaintiff-petitioner "Wouldn't your clients have adequate remedy under Australian law in Australia, in the Australian court system?" Justice Ginsburg said that the case "has Australia written all over it. Isn't the most appropriate choice the law of Australia rather than the law of the United States?" On the other hand, the Court also seemed troubled by an across the board prohibition of such cases, and recognized the problems of the fact intensive "conducts and effects" test.

CONCLUSION

With an increasingly global economy, the question of cross-border application of U.S. securities laws is a serious and growing concern. Although *Morrison* illustrates the challenges plaintiffs confront in obtaining U.S. jurisdiction in f-cubed cases — even when *some* misconduct allegedly occurred there — the threat of such cases must be considered in assessing a bank's risk profile, and making operational decisions that could affect that profile. When the Court ultimately rules (no sooner than late this year), foreign banks and other corporations can only hope they will have a better defined roadmap as to their potential exposure to the profound risks of U.S.-style securities class actions.

NOTES

[1] In 2008, nearly 350,000 cases were filed in U.S. Federal District Courts alone. By contrast, during that same year, England and Wales saw only 35,985 cases filed. Available at http://www.uscourts.gov/caseload2008/contents.html and http://www.justice.gov.uk/publications/courtstatisticsquarterly.htm.

[2] 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.

[3] *Morrison*, 547 F.3d at 170.

[4] *Id*. at 171.

[5] *Id*. at 170.

[6] *See id*. at 175 (noting that plaintiffs only addressed the "conduct" prong of the two-part "conduct and effects" test, choosing essentially to ignore the question whether there were sufficient "effects" in the U.S. to support the exercise of jurisdiction).

[7] Brief for the United Kingdom of Great Britain and Northern Ireland as Amicus Curiae in Support of Respondents, *Morrison v. National Australia Bank, LTD.*, 547 F.3d 167 (2d Cir. 2008).