

# Foreign-Cubed Securities Litigation



Historically, United States securities laws and regulations have been well defined. The same was not always true in the rest

of the world. Admittedly, over the last decade or more, other countries have made significant advances in developing corporate governance and laws and regulations addressing director and officer (D & O) accountability. Securities actions and settlements outside the United States have also increased. Fay Hansen, *D & O Goes Global*, Business Finance, (Sept. 1, 2006), <http://businessfinancemag.com/article/dampogoes-global-0901>; Ted Allen, *More Nations Open the Door to Securities Lawsuits*, Institutional Shareholder Services, Mar. 7, 2006. But the United States has remained the forum of choice for suing both U.S.-based and foreign companies, even among investors. Adam Kemal-Brooke, *European Shareholders in U.S. Class Actions: Is There Any Such Thing as a 'Global Settlement'?* Fishburns Solicitors Bulletin, Winter 2006, [http://www.fishburnslaw.com/uploads/docs/winter\\_bulletin\\_2006.pdf](http://www.fishburnslaw.com/uploads/docs/winter_bulletin_2006.pdf). In fact, even foreign purchasers of the securities of foreign issuers traded on foreign exchanges have filed lawsuits against foreign securities issuers in the United States for violating U.S. securities laws, often referred to as “F-cubed” or “foreign-cubed” litigation. However, based on a recent U.S. Supreme Court ruling, this trend will probably change.

In the nine years of 2000 through 2009, U.S. securities class actions against foreign securities issuers increased, peaking in 2008, as shown in Table 1. See Cornerstone Research, *Securities Class Action Filings, 2009: A Year in Review*, Cornerstone



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Research (2010), [http://securities.stanford.edu/clearinghouse\\_research.html](http://securities.stanford.edu/clearinghouse_research.html). The second highest number occurred in 2007.

U.S. class actions have presented the greatest financial risks to foreign companies, and a number of securities class actions involving foreign corporations have resulted in massive losses for those corporations. For instance, Nortel Networks Corporation (Canada) settled a class action for over \$2 billion, and Royal Ahold (The Netherlands) settled a class action for over \$1 billion. Other large U.S. securities class action settlements have involved DaimlerChrysler (Germany) for \$300 million, Deutsche Telekom (Germany) for \$120 million, Royal Dutch/Shell (The Netherlands) for \$90 million, El An (Ireland) for \$75 million, MTC Electronic Teletechnologies (Canada) for \$70 million, Independent Energy Holdings (UK) for \$48 million, Laidlaw (Canada) for \$42.9 million, Cinar (Canada) for \$27.3 million and Vodafone (UK) for \$24.5 million. See Stanford Law School Securities Class Action Clearinghouse, <http://securities.stanford.edu/>; PricewaterhouseCoopers, *PwC Advisory Crisis Management, 2006 Securities Litigation Study* (2007), [http://10b5.pwc.com/PDF/070918%20SEC%20LIT%20STUDY%202006\\_FINAL\\_66948\\_V2\\_CT.PDF](http://10b5.pwc.com/PDF/070918%20SEC%20LIT%20STUDY%202006_FINAL_66948_V2_CT.PDF).

Securities and Exchange Commission (SEC) enforcement actions against foreign corporations have also been on the rise. Between January 1995 and June 2002, the SEC took legal action against only 13 cross-listed foreign firms. Natalya Shnitser, *A Free Pass for Foreign Firms? An Assessment of SEC and Private Enforcement Against Foreign Issuers*, 119 Yale L.J. 1638, 1658–59 (May 2010) (citing Jordan Siegel, *Can Foreign Firms Bond Themselves Effectively by Renting U.S. Securities Laws?* 75 J. Fin. Econ. 319, 342 (2005)). In 2002, the SEC pursued three enforcement actions against foreign companies. John E. Black Jr. & David T. Burrowes, *D & O Litigation Trends in 2006*, Iirmi.com (June 2006), <http://www.irmi.com/expert/articles/2006/black06.aspx>. The SEC pursued four actions in 2003 and six in 2004. Shnitser, *A Free Pass for Foreign Firms?* *supra*, at 1675. In 2005, the SEC pursued 16 enforcement actions against foreign entities. *Id.* And in 2006, 2007 and 2008, the SEC pursued 12 enforcement

actions each year against foreign companies issuing securities. *Id.*

### The F-Cubed Cases

Until 2010, the U.S. Supreme Court had not considered whether U.S. securities laws' anti-fraud provisions permitted foreign investors to pursue lawsuits in the U.S. courts

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if foreign purchasers of securities sought to sue foreign issuers of securities traded on a foreign exchange. However, on November 30, 2009, the Supreme Court indicated that it would address the split of authority that had arisen in the U.S. Circuit Courts of Appeals about “F-cubed” litigation by reviewing *Morrison v. National Australia Bank Ltd.*, 547 F. 3d 167 (2d Cir. 2008).

Before the U.S. Supreme Court accepted *Morrison* for review, the circuit courts took three different approaches to foreign-cubed litigation. Julius Melnitzer, *F-Cubed Conflict*, Inside Counsel (Mar. 1, 2010), <http://www.insidecounsel.com/Issues/2010/March-2010/Pages/FCubed-Conflict.aspx?>. The D.C. Circuit took the most limiting approach: the court would not accept jurisdiction unless the foreign securities issuer's misconduct in the United States constituted a securities law violation. *Id.* The approach of the Third,

Eighth and Ninth Circuits required only that “some activity designed to further a fraudulent scheme” occur in the United States. *Id.* The Second Circuit's approach, as applied in its *Morrison* decision, “requiring that the domestic acts must be ‘at the heart’ of the fraud before U.S. courts may act,” was considered middle of the road. *Id.*

### The Second Circuit's Decision in Morrison

On October 23, 2008, the Second Circuit concluded that the U.S. courts did not have subject matter jurisdiction over the securities fraud lawsuit against National Australia Bank (NAB). *Morrison v. National Australia Bank Ltd.*, 547 F.3d 167 (2d Cir. 2008). In *Morrison*, foreign investors who purchased NAB shares abroad sued NAB alleging securities fraud and violations of the U.S. securities laws governing foreign transactions. Three of the plaintiffs who purchased their shares abroad sought to represent a class of foreign purchasers of NAB shares. NAB's ordinary shares were traded on exchanges in Australia, London, Tokyo and New Zealand. The fourth plaintiff purchased American Depositary Receipts (ADRs) on the New York Stock Exchange and sought to represent a class of U.S. purchasers. The defendants moved to dismiss the suit of the foreign plaintiffs for lack of subject matter jurisdiction and to dismiss the suit of the domestic plaintiff for failure to state a claim. The district court granted the motion, and the foreign investor plaintiffs appealed. On appeal, the Second Circuit held that the U.S. federal courts lacked subject matter jurisdiction over the claims of foreign claimants if the claimants had bought their shares on a foreign exchange. *Id.* at 176. However, the Second Circuit refused to pronounce a bright-line rule precluding subject matter jurisdiction

**Table 1. Annual number of securities class action filings against foreign issuers 2000–2009\***

Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Number of actions against foreign issuers	12	15	21	16	27	25	13	29	30	21
Percent of all federal securities class actions	5.6	8.3	9.4	8.4	11.9	13.8	11	15.3	13.5	12.4

\*CAF-F Index™, Cornerstone Research, *Securities Class Action Filings, 2009: A Year in Review*, Cornerstone Research (2010), at 11.

in all matters involving foreign issuers, foreign investors or foreign exchanges.

The Second Circuit stated that in determining the extraterritorial reach of section 10(b) of the Securities and Exchange Act of 1934, courts consider “whether the harm was perpetrated” in the United States “or abroad and whether it affected domestic markets and investors” by applying the “conduct test” and the “effects test.” *Id.* at 171. Under the conduct test, a U.S. federal court would have subject matter jurisdiction if the activities undertaken in the United States had been more than just preparatory to a fraud and if the acts or omissions undertaken in the United States directly caused losses to foreign investors. *Id.* at 172. Citing *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974 (2d Cir. 1975), and *IIT v. Vencap, Ltd.*, 519 F.2d 1001 (2d Cir. 1975), the court opined that to determine subject matter jurisdiction under the conduct test a court must identify (1) which action constituted the fraud and directly caused harm, and (2) whether the action emanated from within the United States. *Morrison*, 547 F.3d at 173. The effects test asks whether the conduct had a substantial effect in the United States or on U.S. citizens. Angelo G. Savino, *NAB: Not the Last Word on Foreign-Cubed Securities Litigation*, 10 PLUS Journal, no. 23, Oct. 2010 at 1, 7–9. The Second Circuit decision only discussed the conduct test because the appellants relied entirely on that test in their appeal, and without a domestic appellant, the court did not need to apply the effects test to the claims. *Id.* The appeal, as a “foreign-cubed” matter, involved a set of *foreign plaintiffs suing a foreign insurer* in a U.S. court for violations of U.S. securities laws based on transactions in *foreign countries*. As the Second Circuit explained, the real issue was determining which conduct constituted “the heart of the alleged fraud.” The court found that NAB’s acts and omissions in Australia had been more central to the fraud and more directly responsible for the harm to investors than those occurring in the United States. *Id.* The Second Circuit also noted that the appellants had not alleged that NAB’s fraud affected U.S. investors or capital markets. Due to “the particular mix of factors” in the case, the court concluded that it did not have subject matter jurisdiction over the matter. *Id.*

at \*8. The foreign appellants petitioned the U.S. Supreme Court for certiorari, which the Court granted on November 30, 2009.

### The U.S. Supreme Court’s Decision in *Morrison*

Due to the potential impact on the future of U.S. securities litigation, the appeal to the

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U.S. Supreme Court was hotly contested. Many parties filed amicus curiae briefs on both sides of the debate, including foreign exchanges, U.S. legal organizations, international legal organizations, international companies and the United Kingdom, Australia and France, which asserted that allowing such litigation would interfere with the ability of those countries to adopt their own regulatory approaches. Institute for Legal Reform, *Foreign Securities Class Actions in U.S. Federal Court (‘F-Cubed’)*, <http://www.instituteforlegalreform.com/tort-import/f-cubed.html> (last visited Feb. 28, 2011).

On June 24, 2010, the U.S. Supreme Court affirmed the Second Circuit’s decision in *Morrison*. But in true appellate tradition, the Supreme Court affirmed the Second Circuit’s decision based on vastly different grounds than those of the Second Circuit. In the majority opinion, the Supreme Court concluded that section 10(b) of the Securities and Exchange Act of 1934 did not confer a cause of action to foreign plaintiffs suing foreign and U.S. defendants for misconduct connected with securities traded entirely on foreign exchanges. *Morrison v. National Australia Bank Ltd.*, 130 S. Ct. 2869 (June 24, 2010). In addition to the majority opinion, the justices wrote two concurring opinions. Doing what the Second Circuit refused to do, the U.S. Supreme

Court “drew a bright line around the U.S. borders” for securities fraud cases. Savino, *NAB: Not the Last Word, supra*. The decision also appeared to stifle the SEC’s ability to pursue actions based on foreign-cubed transactions. *Id.*

The Supreme Court focused on the presumption against extraterritorial application of U.S. laws and criticized other courts’ approaches to territorial jurisdiction, including the Second Circuit’s, specifically, that they had ignored the presumption against extraterritoriality. Michelle A. Jones, *F-Cubed Securities Litigation Foiled by the U.S. Supreme Court*, Financial Lines/Directors & Officers/Management Liability Alert, Crowell Moring (June 28, 2010), <http://www.crowell.com/NewsEvents/Newsletter.aspx?id=1507>. To summarize, the Supreme Court rejected the conduct test and the effects test and ultimately concluded that section 10(b) of the Securities and Exchange Act of 1934 did not apply extraterritorially because the Act did not affirmatively indicate that it applied extraterritorially. *Morrison*, 130 S. Ct. at 2883.

### The Vivendi Case Goes to Trial

While the *Morrison* appeal was pending before the U.S. Supreme Court, another foreign-cubed case proceeded in the U.S. District Court of the Southern District of New York in the Second Circuit. *See In re Vivendi Universal, S.A. Securities Litigation*, 241 F.R.D. 213 (S.D.N.Y. Mar. 22, 2007) (No. 02 Civ. 5571), *superseded by* 242 F.R.D. 76 (S.D.N.Y. May 21, 2007) (correcting typographical errors incorrectly stating the plaintiffs’ proposed class period). In *Vivendi*, the plaintiffs sought to certify a class under Federal Rules of Civil Procedure 23(a) and (b)(3) consisting of all persons, foreign and domestic, who purchased or otherwise acquired ordinary shares or ADRs of Vivendi between October 20, 2000 and August 14, 2002. *Id.* at 217. The plaintiffs alleged that the company and its two most senior, former officers committed securities fraud, specifically violations of sections 10(b) and 20(a) of the Securities and Exchange Act of 1934 and SEC Rule 10b-5, as well as sections 11, 12(a) and 15 of the Securities Act of 1933. *Id.* at 217 n.2. The plaintiffs maintained that “the defendants’ materially false and misleading statements caused Vivendi

stock to trade at artificially inflated prices” and “induced them to purchase or acquire stock pursuant to a registration statement and prospectus dated October 30, 2000, issued in connection with” Vivendi’s merger with Seagram Company Limited and Canal Plus. *Id.* at 217.

In *Vivendi*, the district court concluded that the plaintiffs had satisfied the Federal Rule of Civil Procedure 23(a) numerosity, commonality and typicality requirements. Respecting the Federal Rule of Civil Procedure 23(b)(3) requirements, the court primarily focused on whether foreign purchasers of ordinary shares in the class “would subject defendants to the risk of duplicative litigation and inconsistent results, to the extent that foreign courts could be unwilling to recognize and enforce any judgment or settlement ultimately reached in the case.” See Troutman Sanders, *D & O Liability—Court Certifies Class of Foreign and Domestic Shareholders*, (Mar. 28, 2007), <http://www.troutmansanders.com/do-liability---court-certifies-class-of-foreign-and-domestic-shareholders-03-28-2007/>; *Vivendi*, 241 F.R.D. at 227–47. The court reasoned that while a court should evaluate, among other factors, the likelihood that a foreign court would not recognize or enforce an U.S. settlement or an U.S. judgment, a court should not view “the mere possibility” of those scenarios as automatically determinative. *Vivendi*, 241 F.R.D. at 232–33; Troutman Sanders, *D & O Liability—Court Certifies Class, supra*. The *Vivendi* court found that French, English and Dutch shareholders were properly included in the class. *Vivendi*, 241 F.R.D. at 247; Troutman Sanders, *D & O Liability—Court Certifies Class, supra*. However, the court noted that German and Austrian courts were unlikely to recognize an U.S. judgment or an U.S. settlement. *Vivendi*, 241 F.R.D. at 242–45; Troutman Sanders, *D & O Liability—Court Certifies Class, supra*. Germany does not recognize class actions, Austria requires a formal reciprocity agreement with a foreign state as a condition to recognition and the United States does not have an agreement with Austria. *Vivendi*, 241 F.R.D. at 242–45; Troutman Sanders, *D & O Liability—Court Certifies Class, supra*. So the court excluded German and Austrian shareholders from the class. *Vivendi*,

241 F.R.D. at 247; Troutman Sanders, *D & O Liability—Court Certifies Class, supra*.

*Vivendi* moved to dismiss the case because while investors in the United States held 25 percent of its shares as ADRs, citizens of other countries held the rest. Eriq Gardner, *Vivendi Verdict Highlights Potential Costs of F-Cubed Lawsuits*, Inside Coun-

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should curtail the efforts  
of plaintiffs’ lawyers to  
find foreign investors who  
purchase foreign stock  
on foreign exchanges to  
serve as plaintiffs in U.S.  
securities litigation.

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sel (Apr. 1, 2010), <http://www.insidecounsel.com/Issues/2010/April-2010/Pages/Vivendi-Verdict-Highlights-Potential-Costs-of-FCubed-Lawsuits.aspx>. Rejecting *Vivendi*’s motion, the district court applied the conduct test and the effects test. Examining whether the allegedly fraudulent conduct occurred in the United States and whether it had a substantial effect in the United States, the court concluded “that significant alleged conduct occurred in the United States warranting application of the federal securities laws to foreign actors.” *Vivendi*, 241 F.R.D. at 244.

In December 2009, in a very rare occurrence for securities fraud cases, the *Vivendi* case went to trial. On January 29, 2010, the jury returned a verdict in favor of the plaintiffs. On June 29, 2010, the U.S. District Court for the Southern District of New York asked the parties in *Vivendi* to brief the impact of the U.S. Supreme Court’s *Morrison* decision to the case. Robert Cox, Andrew Lazerow & Tonya Gaskins, *The Supreme Court Slams the Door to U.S. Courts for F-Cubed Litigation*, The Defender, Howrey (Summer 2010), <http://thedefender.howrey.com/>

the-supreme-court-slams-the-door-to-us-courts-for-f-cubed-litigation-07-19-2010/. By July 16, 2010, the issue had been fully briefed and was pending before the district court. The *Vivendi* plaintiffs argued that the *Morrison* decision did not affect the verdict against *Vivendi* in favor of ADR purchasers or U.S. or foreign purchasers of ordinary shares listed on an U.S. exchange. *Vivendi* argued that under *Morrison*, the court should enter judgment as a matter of law dismissing the section 10(b) claims of all shareholders who purchased *Vivendi* ordinary shares. The court issued a memorandum opinion and order on February 17, 2011. *In re Vivendi Universal Securities Litigation*, \_\_\_ F. Supp. 2d \_\_\_, 2011 WL 590915 (S.D.N.Y. Feb. 17, 2011) (No. 02 Civ. 05571). The court concluded that the section 10(b) claims of ordinary share purchasers in the U.S., like the claims of foreigners who purchased *Vivendi* ordinary shares, did not survive *Morrison* and were dismissed. *Id.* at \*12. The court amended the class definition to exclude all purchasers of ordinary shares. *Id.*

### Post-*Morrison* U.S. Securities Actions Against Foreign Issuers

The need for transparency in the global securities markets has resulted in an increase in regulatory enforcement and shareholder investor activity throughout the world against publicly held corporations and their directors and officers. Although plaintiffs increasingly have pursued U.S. securities class actions against foreign entities, the Supreme Court’s decision in *Morrison* appears to be an important victory for foreign companies. Lawsuits by foreign investors who purchased securities of foreign companies on foreign exchanges are now beyond the reach of the U.S. federal securities laws and courts. U.S. investors will not be able to infringe on the rights of other countries to regulate securities sales within their own borders. Institute for Legal Reform, *Foreign Securities Class Actions, supra*. Although the *Morrison* ruling would have prevented the SEC from pursuing actions against foreign companies under section 10(b) of the Securities and Exchange Act, since the Court issued that decision Congress has passed legislation that enhanced the SEC’s enforcement

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power against foreign securities issuers. Fredric D. Firestone, Eugene I. Goldman & Michael A. Ungar, *SEC Enforcement Given New Tools Under Dodd-Frank Bill*, McDermott Will & Emery, McDermott Newsletters (July 21, 2010), [http://www.mwe.com/index.cfm/fuseaction/publications.nldetail/object\\_id/dded2cf9-b70e-4d16-9a97-79d2f66ec714.cfm](http://www.mwe.com/index.cfm/fuseaction/publications.nldetail/object_id/dded2cf9-b70e-4d16-9a97-79d2f66ec714.cfm).

The Dodd-Frank Wall Street Reform and Consumer Protection Act, which became law July 21, 2010, gave federal district courts jurisdiction over SEC actions charging entities with violating federal securities law anti-fraud provisions if misconduct in the United States has significantly furthered those violations, even if the entities traded the securities outside of the United States and the transactions only involved foreign traders, or if misconduct that happened abroad had “a foreseeable substantial effect within the United States.” *Id.* This extraterritorial jurisdiction will assist the SEC in cases involving foreign misconduct or actors. *Id.*

At this time, what remains unclear is the potential impact of the *Morrison* decision on domestic purchasers of foreign securities. See James Weidner, *et al.*, *F-Cubed Gets an F Grade from U.S. Supreme Court*, Clifford Chance Client Memorandum (June 26, 2010), [http://www.cliffordchance.com/publicationviews/publications/2010/06/f-cubed\\_gets\\_an\\_fgradedfromussupremecourt.html](http://www.cliffordchance.com/publicationviews/publications/2010/06/f-cubed_gets_an_fgradedfromussupremecourt.html). Specifically, the *Morrison* decision may not preclude “F-squared litigation,” meaning claims pursued by U.S.-domiciled investors who purchased securities of a foreign company on a foreign exchange. Kevin LaCroix, *O.K., F-Cubed Claims Are Out, But What About F-Squared Claims?* The D & O Diary (July 21, 2010), <http://www.dandodiary.com/2010/07/articles/securities-litigation/ok-fcubed-claims-are-out-but-what-about-fsquared-claims/>; Erik Krusch, *Litigation Watch: “F” Securities Class Actions*, Westlaw Business Currents (Aug. 6, 2010). Moreover, whether U.S. purchasers of ADRs will still be able to sue foreign companies trading on foreign exchanges has not yet been challenged.

Cox, *The Supreme Court Slams the Door, supra*.

What is clear, at least for now, is that in the near future to determine whether U.S. securities law anti-fraud provisions apply in a case a court will consider the location of purchases and sales rather than the location of investors, the location of alleged misconduct, or the location of the effect of misconduct. *Id.* The *Morrison* decision should curtail the efforts of plaintiffs’ lawyers to find foreign investors who purchase foreign stock on foreign exchanges to serve as plaintiffs in U.S. securities litigation. The decision may also influence whether foreign companies choose to list their securities on U.S. exchanges. See *id.* However, in light of the ever-expanding global economy and the economic interests fueled by foreign investments, Congress likely will take legislative action to establish a basis of relief for U.S. and foreign investors to sue foreign securities issuers. Thus, the ultimate impact of the *Morrison* decision remains to be seen. 