By

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The Antifraud Provisions of the U.S. Securities Laws: IN GLOBAL MARKETS, JUST HOW FAR CAN THEY REACH?

As cross-border securities transactions continue to become more common in ever more globalized markets, plaintiffs' attorneys predictably will continue to push the extraterritorial limits of the antifraud provisions of the U.S. federal securities laws. The last several years have seen increasing numbers of non-U.S. issuers named as defendants in securities-fraud class actions. It also is no longer unusual to see non-U.S. investors as plaintiffs in such cases, including as lead plaintiffs. The extraterritorial reach of the U.S. securities laws is not endless, but it is expansive. One area that bears watching is whether the federal courts will allow U.S. securities actions to be maintained by non-U.S. investors who purchased the securities of non-U.S. issuers on non-U.S. exchanges. Some courts have allowed such claims to proceed, while other courts have not.

THE RISE IN LITIGATION INVOLVING NON-U.S. ISSUERS

Non-U.S. plaintiffs' attraction to the U.S. courts, and would-be plaintiffs' attempts to bring non-U.S. defendants before U.S. courts, are understandable, given the characteristics of litigation in the United States that differentiate it from litigation in most other countries. Extensive and

intrusive pre-trial discovery is available in U.S. litigation, helping plaintiffs to "build" their cases after filing them. Punitive damages can be sought. Plaintiffs' counsel can recover contingency fees. There is less risk for a plaintiff because the so-called "American rule" applies with respect to attorneys' fees; unsuccessful plaintiffs do not usually have to pay the defendants' fees and costs. Securities-fraud cases can be pursued as class actions, seeking damages on behalf of thousands of absent class members. And, last but not least, liability is often decided by a jury, not by the judge.

Thus, it is not particularly surprising that, with the number of securities-fraud class actions climbing in recent years and the settlement amounts growing larger, plaintiffs have shown a steady inclination to reach overseas to find additional defendants. In 2004, when the total number of securities-fraud class-action filings reached a record high of 203 new cases, the number of suits against non-U.S. issuers rose right along with it, to a record 29 such suits filed against non-U.S. companies (a 93 percent increase over the prior year). According to PricewaterhouseCoopers' "2005 Securities Litigation Study," in 2005 the total number of cases filed dropped somewhat (to 19 cases against non-U.S. issuers), but it still was the third-highest number of the last 10 years, and the proportion of cases against non-U.S. issuers remained roughly the same. In sum, it has become more common for investors to assert claims in U.S. courts against non-U.S. defendants. And, perhaps because of the increased frequency with which sophisticated institutional investors have initiated securities-fraud class actions, it also has become more common to see non-U.S. plaintiffs venturing into the U.S. courts.

Few substantial subject-matter jurisdiction issues are presented when a non-U.S. investor purchases shares of an American company on an American exchange. Likewise, the existence of federal subject-matter jurisdiction is unremarkable when an investor, U.S. or not, has purchased a non-U.S. corporation's American Depositary Receipts or American Depositary Shares on a U.S. exchange. In each circumstance, the plaintiff alleges that it has suffered loss through activity directly related to the U.S. securities markets. A more difficult issue arises, however, when a non-U.S. investor who purchased securities of a non-U.S. corporation on a *non-U.S.* exchange asserts claims under the U.S. securities laws. In that case, the extraterritorial application of the U.S. securities laws should face higher hurdles, given that such cases may have an attenuated connection to the United States.

THE EXTRATERRITORIAL APPLICATION OF THE SECURITIES LAWS

The Securities Exchange Act bestows upon federal courts exclusive subject-matter jurisdiction to hear claims under the U.S. securities laws (*see* 15 U.S.C. § 78aa), but it is silent about the question of extraterritorial application. Federal courts examining the securities laws' extraterritorial reach, in cases stemming from "predominantly foreign" frauds, have therefore sought to "determine whether Congress would have wished [that] the precious resources of the United States courts . . . be devoted to them rather than leave the problem to foreign countries." *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 985 (2d Cir. 1975), *cert. denied*, 423 U.S. 1018, 96 S. Ct. 453 (1975); *see also Tri-Star Farms Ltd. v. Marconi, PLC*, 225 F. Supp. 2d 567, 571–72 (W.D. Pa. 2002).

In this regard, the federal courts have developed two tests to determine whether their subject-matter jurisdiction should extend to cases involving non-U.S. frauds. One analysis—the "conduct" test—focuses on whether conduct within the United States is alleged to have played some part in the perpetration of a securities fraud on investors outside the country. *See, e.g., Europe and Overseas Commodity Traders, S.A. v. Banque Paribas London*, 147 F.3d 118, 125–26 (2d Cir. 1998), *cert. denied*, 525 U.S. 1139, 119 S. Ct. 1029 (1999); *Cromer Finance Ltd. v. Berger*, 137 F. Supp. 2d 452, 479–80 (S.D.N.Y. 2001). The other analysis—the "effects" test—focuses on whether conduct outside the United States had a substantial adverse effect on United States investors or United States securities markets. *See Tri-Star Farms Ltd.*, 225 F. Supp. 2d at 571–76. Satisfaction of either test may independently establish jurisdiction. *See Robinson v. TCI/US West Communications Inc.*, 117 F.3d 900, 905 (5th Cir. 1997).

Some courts have held that non-U.S. plaintiffs who did not purchase securities on a U.S. exchange cannot invoke subject-matter jurisdiction in federal courts over securities-law claims under the "effects" test. *See Tri-Star Farms Ltd.*, 225 F. Supp. 2d at 573. Even where other investors in the same securities were U.S. citizens or non-U.S. citizens purchasing securities on a U.S. exchange, these courts have held that non-U.S. plaintiffs who purchased their securities outside

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the United States cannot ride the coattails of U.S. investors into the U.S. courts. *See, e.g., McNamara v. Bre-X Minerals, Ltd.*, 32 F. Supp. 2d 920, 923–24 (E.D. Tex. 1999); *Kaufman v. Campeau Corp.*, 744 F. Supp. 808, 810 (S.D. Ohio 1990).

Non-U.S. plaintiffs seeking to invoke the subject-matter jurisdiction of United States courts therefore must usually do so on the basis of the defendant's relevant conduct within the United States. Under the "conduct" test, the plaintiff bears the burden of justifying the court's exercise of jurisdiction by showing, in part, that the defendant's conduct within the U.S. was substantial in comparison to the allegedly fraudulent conduct committed outside the United States. *See Europe and Overseas Commodity Traders, S.A.*, 147 F.3d at 126–28. In a seminal decision, the Second Circuit established the threshold requirements of the "conduct" test. It held that the antifraud provisions of the federal securities laws "[d]o not apply to losses from sales of securities to foreigners outside the United States unless acts (or culpable failures to act) within the United States directly caused such losses." *Bersch*, 519 F.2d at 993. The *Bersch* court went on to state that non-U.S. plaintiffs may not assert claims under federal securities laws "where the United States activities are merely preparatory or take the form of culpable nonfeasance and are relatively small in comparison to those abroad." *Bersch*, 519 F.2d at 997 (holding that plaintiffs failed to invoke the court's subject-matter jurisdiction, despite United States conduct that included meetings of attorneys, underwriters, and accountants in New York to initiate, organize, and structure the securities offering at issue; retention of a New York law firm to represent the underwriters; and meetings with the SEC).

A NON-U.S. PLAINTIFF, A NON-U.S. DEFENDANT, AND A NON-U.S. EXCHANGE

Based upon *Bersch* and its progeny, many courts have held that putative non-U.S. plaintiffs may not initiate litigation in the United States under American securities laws when the non-U.S. investor purchased its securities on a non-U.S. exchange. *See, e.g.*, *Tri-Star Farms Ltd.*, 225 F. Supp. 2d at 576–81 (no subject-matter jurisdiction to hear claims of non-U.S. plaintiffs who purchased securities outside the United States where the alleged fraudulent scheme was conceived in the United Kingdom by British citizens and involved shares of a British corporation traded on a non-U.S. exchange, and non-U.S. citizens were responsible for the alleged wrongful misrepresentations and omissions); *Fidenas AG v. Compagnie Internationale Pour L'Informatique CII Honeywell Bull S.A.*, 606 F.2d 5, 7–10 (2d Cir. 1979) (affirming dismissal for lack of subject-matter jurisdiction where nearly all of the acts complained of took place outside the United States, the plaintiffs were non-U.S. companies and a non-U.S. person, and all but one of the defendants were non-U.S. companies).

Plaintiffs, however, have continued to knock on the extraterritorial door, asserting claims based upon non-U.S. purchases of non-U.S. securities by non-U.S. investors, all by searching for some alleged connection to the United States. In recent cases, these attempts have met with mixed results. Some courts have recognized few borders and adopted the apparent view that information released to investors in one country, once disseminated, has a global reach. Others have adhered to the more conservative view that the span of information, and the reach of U.S. law, is not endless.

One good example of a court taking a broad view of the reach of the Exchange Act was in *In re Vivendi Universal S.A. Sec. Litig.*, 381 F. Supp. 2d (S.D.N.Y. 2003). There, a putative class brought securities-fraud claims contending that Vivendi, a French corporation that was not registered to do business in the U.S., inflated its stock price through various false and misleading statements made in connection with Vivendi's American Depositary Receipt filings and otherwise made in the United States. Vivendi moved to dismiss for lack of subject-matter jurisdiction the claims brought by non-U.S. members of the purported class who had bought Vivendi stock on markets outside the United States. Applying the "conduct" test, the court denied the motion, based in substantial part on the fact that some of the purportedly false statements were made after Vivendi's chief executive officer and chief financial officer had relocated to New York "allegedly to better direct corporate operations [of Vivendi subsidiaries] and more effectively promote misleading perceptions on Wall Street. . . ." On the basis of those allegations, the court essentially viewed the global financial markets as without informational borders, finding that it would be reasonable to infer that "the alleged fraud on the American exchange was a 'substantial' or 'significant contributing cause' of foreign investors' decisions to purchase Vivendi's stock abroad." *Id*.

Subject-matter jurisdiction over similar claims of non-U.S. investors was also sustained in *Royal Dutch/Shell Transport Sec. Litig.*, 380 F. Supp. 2d 509 (D.N.J. 2005). There, plaintiffs alleged that defendants had disseminated false statements about the level of Royal Dutch/Shell's oil reserves, which artificially inflated the purchase price of their stock. Again, defendants argued that the court lacked subject-matter jurisdiction over the claims of non-U.S. nationals in the putative class who purchased their shares on exchanges outside the U.S. Defendants argued that the United States was not the location of "substantial and material" conduct because the companies were European companies that ran their operations from European headquarters, and the "focal point" of alleged fraudulent activity was in the United Kingdom and the Netherlands. Defendants also asserted that roughly 92 percent of the defendant companies' shares were traded outside the United States. 380 F. Supp. at 539, 541.

The court denied the motion, finding that subject-matter jurisdiction could be based on allegations that some work in calculating reserves, some auditing of reserves, and some presentations to analysts and investors took place in the United States. To distinguish other cases where jurisdiction had been found lacking, the court in *Royal Dutch/Shell Transport* rejected as "oversimplified" the assertion that these activities were pertinent only to United States investors. Coming close to finding international markets to be fungible from the standpoint of information dissemination, the court found that "[j]ust as foreign stock exchange data and information is pertinent to United States investors, the reverse is also true." 380 F. Supp. at 545. Thus, the court held, "[t]he Companies' alleged fraudulent conduct which took place in the United States would, therefore, affect foreign as well as domestic investors." *Id*.

In contrast to *Vivendi* and *Royal Dutch/Shell Transport*, other courts have not found allegations of United States activity so easily connected to investment decisions made by investors outside the United States effecting transactions on non-U.S. markets. In *Blechner v. Daimler-Benz AG*, 410 F. Supp. 2d 366 (D. Del. 2006), the court expressly declined to follow the rationale of *Royal Dutch/Shell Transport*, emphasizing instead the general canon of statutory interpretation that "[u]nless Congress has expressed intent otherwise, courts should avoid the extraterritorial application of laws." 410 F. Supp. 2d at 368. Against that more conservative backdrop, the *Blechner* court rejected for lack of subject-matter jurisdiction securities-fraud claims asserted by a putative class of non-U.S. investors who purchased, or otherwise acquired by exchanging their shares in Chrysler Corporation, shares in a German company, DaimlerChrysler AG. Plaintiffs alleged that defendants had made material misrepresentations, mischaracterizing the merger of Daimler-Benz and Chrysler as a "merger of equals" when, in fact, it was an acquisition of Chrysler. The alleged class of plaintiffs included non-U.S. investors who made their purchases or exchanges "through a securities exchange not based in the United States." 410 F. Supp. 2d at 367.

The *Blechner* court found that the conduct alleged to have occurred within the United States was "not essential" to the alleged plan to defraud. 410 F. Supp. 2d at 371. Of particular interest, however, the *Blechner* court appears to have rejected the "information is globally fungible" approach of the courts in *Vivendi* and *Royal Dutch/Shell Transport*,

finding no jurisdiction even though "the company acquired was an American corporation and . . . many of the alleged victims of the fraud were American. . . ." 410 F. Supp. 2d at 371. Taking a stricter view about extraterritoriality, the court found no subject-matter jurisdiction existed because, as to the plaintiffs themselves, "the investors are not American, did not use an American exchange, and did not suffer any effects of the alleged wrongful conduct in the United States." *Id*. at 373. Applying the "conduct" test, the court found that "the conduct that comprises plaintiffs' claims occurred predominantly outside the United States."

In a similarly conservative opinion, the court in *In re: Bayer AG Sec. Litig.*, 423 F. Supp. 2d 105 (S.D.N.Y. 2005), also found no subject-matter jurisdiction under the "conduct" test. Plaintiffs asserted that defendants Bayer AG (a German company) and Bayer Corp. (an Indiana corporation based in Pennsylvania) had disseminated false and misleading statements in the United States (i) to obtain FDA approval for the drug Baycol and (ii) in statements concerning Baycol made in registration statements filed with the SEC when Bayer AG decided to offer securities for sale in the United States.

Even in light of those allegations of U.S.-based conduct, the court found no subject-matter jurisdiction. The court noted that, even as to the statements made in SEC filings, it was appropriate to "consider whether the documents at issue 'emanated from a foreign source.' " 423 F. Supp. 2d at 112. The court found that the statements in Bayer AG's SEC filings ultimately emanated from Germany, not from conduct in the United States. Hence, the court held that subject-matter jurisdiction was absent because the filing could not "support an extension of jurisdiction over an overwhelmingly foreign putative class." *Id*.

As in *Blechner* and *Bayer*, the court in *Burke v. China Aviation Oil (Singapore) Corp. Ltd.*, 421 F. Supp. 2d 649 (S.D.N.Y. 2005), declined to find subject-matter jurisdiction under the "conduct" test after determining that access to a company's web site in the United States was not by itself sufficient conduct in the U.S. to confer jurisdiction. In *Burke*, a New York shareholder brought a securities-fraud class action against a Singapore issuer whose shares traded on non-U.S. exchanges but could be purchased in the U.S. through the Over-the-Counter Bulletin Board. *Id.* The court found that the issuer did not intentionally market its stock in the U.S., notwithstanding the ability of U.S. investors to access the issuer's web site in the U.S. *Id.* at 653. It held that "U.S. investors in clicking on the [issuer's] website took the action which could cause the information to be transmitted to the United States." *Id.* In so holding, the court noted that "[w]ere the Court to view it otherwise, any foreign corporation with a website would be subject to securities fraud litigation in the United States if a United States resident had bought its securities from some market maker in this country." *Id.*

In a similarly conservative approach, the Southern District of New York recently decided in *In re Nat'l Australia Bank Sec. Litig.*, No. 03 Civ 6537, 2006 WL 3844465 (S.D.N.Y. Oct. 25, 2006), that no subject-matter jurisdiction existed over an Exchange Act Section 10(b) class action when non-U.S. acts, and not U.S. acts, directly caused the losses of the lead non-U.S. plaintiffs. The action involved both lead non-U.S. and lead U.S. plaintiffs. The lead non-U.S. plaintiffs were Australian residents who claimed that they were defrauded in the purchase of defendant issuer's shares that traded on an Australian securities exchange, and the lead U.S. plaintiff was a U.S. resident who purchased quantities of issuer's ordinary shares in the form of American Depositary Receipts. *Id.*

The court, following *Bersch*, found that "where the effects of an alleged fraud are predominantly foreign, the amount of domestic conduct and its nexus to the alleged injury required to sustain jurisdiction is at its greatest." *Id.* at *3. The court added that this rule is "especially true in a class action involving both foreign and domestic plaintiffs . . . where the danger exists that a 'very small tail' may be 'wagging an elephant'." *Id.* The court dismissed the action after finding, among other things, that there was no subject-matter jurisdiction over the non-U.S. plaintiffs' claims. *Id.* at *8–9. Only the lead U.S. plaintiff was given leave to file an amended complaint. *Id.* at *9.

CONCLUSION

The debate about the application of the antifraud provisions of the U.S. securities laws to non-U.S. purchasers on exchanges outside the United States clearly is not over. We can expect plaintiffs' attorneys to continue to search for a way to plead a viable U.S. nexus in securities-fraud cases where—as is now often the case—non-U.S. purchasers are

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included in the putative class. Defendants in such actions will be well advised to address such allegations in detail to demonstrate that the "core" of the alleged fraud took place outside the United States. In a world of transnational securities markets, and with a growing assumption in many quarters that all information is global, this will become increasingly difficult to do. However, decisions such as *Blechner* and *Bayer AG* suggest that the courts may still be convinced to refrain from extraterritorial application of the U.S. securities laws. ■

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