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European Supplement
Advocate
FOR INSTITUTIONAL INVESTORS
A Securities Fraud and Corporate Governance Newsletter

Second Quarter 2008

American Securities Class Actions: The Future of European Litigants in U.S. Courts

by Beata Gocyk-Farber

With increasing globalization of the capital markets, American securities class actions are becoming more common among European investors. A recent study by Securities Class Action Services concluded that 182 European investors applied for lead plaintiff positions in securities class actions in the United States from 1999 through 2007. That number is expected to grow. Although several European jurisdictions are in the process of adopting their own class or group action procedures, the United States—with its broad discovery procedures and potentially large jury verdicts—remains the preferred forum. The U.S. courts, however, do not seem to be enthused about becoming a forum for global securities class actions. Indeed, recent decisions indicate a shift in U.S. courts to limit their jurisdiction to predominantly American disputes. Here, we examine the obstacles that foreign litigants may encounter in U.S. courts as well as strategies for efficient resolution of international securities fraud claims.

The Advantages of the U.S. Courts for Foreign Securities Plaintiffs

The United States has long provided an attractive forum for foreign plaintiffs, particularly in securities litigation, since U.S. securities laws provide a well-developed legal framework for resolution of cases based on fraud or corporate malfeasance. Moreover, American civil procedure offers a comparatively plaintiff-friendly setting. For example, in the United States:

- securities plaintiffs have a right to jury trial, which carries a threat of large verdicts;

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- securities cases can be resolved through individual or class actions not available in other countries; and
- broad discovery rules entitle securities plaintiffs to significant evidence from defendants.

Furthermore, the U.S. system allows for a contingent legal fee structure, which means that lawyers representing plaintiffs assume all the costs and risks of the litigation (frequently millions of dollars), and are only compensated, if they are successful, from recoveries made on behalf of the class. The contingent fee structure is typically not available in other jurisdictions, although third-party funding of group litigations —by insurers or other financial institutions—is on the rise in the U.K.

Finally, U.S. securities laws recognize what is called a "fraud-on-the-market" presumption of reliance. This presumption permits courts to find adequate reliance in an open and developed securities market. Thus, an investor who purchases a security in an "efficient" market is presumed to have relied on public information about that security. No such presumption is recognized by any European jurisdiction.

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Obstacles to Foreign Litigants

Does the Court Have Subject Matter Jurisdiction?

To resolve a case, a U.S. court must have subject matter jurisdiction over the claims before it. To ascertain whether it has jurisdiction in trans-national cases, the U.S. courts utilize what are commonly referred to as "conduct" and "effects" tests. The "conduct test" considers to what extent the alleged fraudulent conduct occurred in the United States, while the "effects" test considers whether illegal activity abroad caused a substantial adverse effect on American investors or American securities markets. To satisfy the "conduct" test, the conduct by a foreign issuer or its officers in the United States has to "directly cause" investor losses. To satisfy the "effects" test, a foreign issuer's conduct has to result in injury to investors in whom the United States has an interest (e.g., American investors or foreign investors who purchased securities on an American stock exchange).

Foreign investors who purchased securities of a foreign issuer on a foreign exchange (so called "F-Cubed" investors) are particularly susceptible to jurisdictional challenges under the "conduct" test. American investors or foreign investors who purchased securities on U.S. stock exchanges are less susceptible to jurisdictional challenges. Under the "effects" test, subject matter jurisdiction is present when fraudulent conduct—even if perpetrated entirely abroad—has effects on American investors or American markets.

In recent securities litigations against foreign issuers, including the *Parmalat Securities Litigation*, the *Royal Dutch Shell Securities Litigation* and the *In re SCOR Securities Litigation* (formerly, Converium), courts dismissed claims brought by F-Cubed investors based on lack of sufficient U.S. conduct, but sustained claims of American investors or foreign investors who purchased securities on U.S. exchanges, because those investors satisfied the "effects" test. The trend to dismiss claims by F-Cubed investors based on lack of U.S. conduct—though seemingly increasing—should not be overestimated, as U.S. conduct was found in numerous recent cases against foreign issuers, including in the *Vivendi Securities Litigation, In re Royal Ahold Securities Litigation, Cable & Wireless Securities Litigation* and *Alstom Securities Litigation*.

About the Author

Ms. Gocyk-Farber is involved in all areas of the firm's litigation practice, with particular emphasis on securities fraud actions, complex commercial litigation, and trial practice. Among other matters, she was a senior member of the litigation and trial team that prosecuted *In re WorldCom, Inc. Securities Litigation,* resulting in a recovery for investors of over $6.15 billion — the second largest securities fraud recovery in the history of the financial markets.

Ms. Gocyk-Farber also has extensive experience in prosecuting executive compensation cases and is one of the senior lawyers prosecuting the federal derivative action against the individuals involved in the options-backdating scandal at United Health Group, Inc.

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Is a Class Action the Best Plan?:

Superiority and Judgment Non-Recognition

The United States Federal Rules of Civil Procedure set out several criteria that must be satisfied for a class action to proceed. One is that a class action must be a superior (*i.e.,* the most efficient) method of resolving the case. Defendants use this rule to challenge the use of U.S. courts to resolve trans-national securities fraud disputes involving foreign plaintiffs, arguing that foreign courts might not recognize judgments reached in U.S. courts. If judgments of U.S. courts are not recognized in foreign courts, then defendants may be sued by foreign plaintiffs again in their local courts for the same conduct. This scenario—defendants argue—would defeat the superiority of the class action as the most efficient means to resolve the dispute.

There is disagreement among U.S. courts as to which foreign plaintiffs, if any, should be excluded from U.S. class actions based on this argument. For example in the *Bersch Securities Litigation,* the court excluded from the class investors from England, Germany, Switzerland, Italy, and France. However, in the *Vivendi Securities Litigation* the court allowed English, French, and Dutch

plaintiffs to stay in the class, but excluded German and Austrian investors. In yet another case addressing this issue, the *Cromer Finance Limited Securities Litigation,* the court applied a more lenient standard, and allowed all foreign investors to stay in the class.

Courts that put credence in the judgment non-recognition argument may look at expert submissions for indications as to whether the U.S. judgment will be enforced abroad. These submissions take the form of affidavits by experts in the laws of the countries in which potential class members reside. In *Vivendi*, for example, the litigants submitted competing affidavits by foreign legal experts, and the court relied heavily on these affidavits in deciding which foreign residents to admit to the U.S. class.

"Fraud on the Market" Not Recognized

Perhaps the most potent obstacle to foreign securities plaintiffs in the U.S. comes from a recent decision in the *Astrazeneca Securities Litigation*. In *Astrazeneca*, the court declined to extend the fraud-on-the-market presumption to claims of foreign investors, holding that U.S. law does not recognize a "global" fraud-on-the-market presumption. Without the presumption, foreign class plaintiffs could not prove reliance on the same publicly-available information as U.S. plaintiffs and could not show that the issuer's conduct directly caused their loss. The court's reasoning in *Astrazeneca* seems to demonstrate recent concern among U.S. judges that the U.S. securities laws could be "overreaching". In denying foreign plaintiffs claims, the court observed that:

Courts that have rejected a global fraud-on-the-market theory have done so because of a concern that allowing foreign purchasers on foreign exchanges to plead reliance in this manner would extend the jurisdictional reach of the United States securities laws too far.

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Solutions

Fortunately, foreign investors dismissed from U.S. class actions may have alternative means to pursue their claims depending on the reasons for dismissal.

A. Individual Actions

Foreign investors who were excluded from a U.S. class action due to a finding that a foreign court would not recognize a class action judgement issued by a U.S. court may chose to file individual suits in the U.S. provided that they can demonstrate sufficient U.S. conduct to establish subject matter jurisdiction. Indeed, after certain of the foreign plaintiffs were recently excluded from the *Vivendi* case, they filed numerous individual cases in the United States, many of which are still pending.

B. Dutch Act on Collective Settlements

Foreign investors who were excluded from the U.S. class actions based on lack of subject matter jurisdiction have a more difficult road. One potential solution lies in the Dutch Act on Collective Settlement of Mass Damages, a 2005 Dutch law which allows a U.S.-style settlement for all class members who do not affirmatively opt out of the settlement. Since the Act provides only for opt-out class settlements, and not for initiation of opt-out class actions, it has been used to settle U.S. civil suits on behalf of foreign investors who were excluded from U.S. class actions.

One of the most notable examples of this novel procedure was the European settlement of the *Royal Dutch Shell* litigation. More recently, the foreign plaintiffs in *In re SCOR Securities Litigation*—who were excluded from the U.S. class action for lack of subject matter jurisdiction—achieved the first pan-European settlement, which they intend to enforce through the Dutch Act. As final approval of the *Royal Dutch Shell* settlement is pending and other settlements, like *SCOR*, are being filed, the Netherlands may become a new center for global class actions.

C. European Actions

Finally, investors dismissed from U.S. courts may want to find another suitable forum. Indeed, in June, Italian plaintiffs dismissed from the U.S. *Parmalat* securities class action announced that they intend to file a new lawsuit in Italy in early fall. As noted earlier, however, few jurisdictions have the well-developed securities laws and class action and discovery procedures of the U.S., so the effectiveness of European class or group actions is yet to be determined.

Securities class actions are no longer purely a U.S. phenomenon. An increasing number of European investors are no longer willing to leave money on the table and are seeking to become active participants in securities litigation. The question is whether the U.S. will continue to open its doors to European plaintiffs. As noted above, some recent decisions suggest a trend to the contrary. As a result, European investors should actively monitor developments in U.S. courts since, in some cases, passive reliance on U.S. class action settlements may no longer be enough.

About the Firm

Bernstein Litowitz Berger & Grossmann LLP ("BLB&G") is the leading law firm worldwide advising institutional investors on issues related to corporate governance, shareholder rights, and securities litigation. We provide comprehensive asset protection services, including portfolio monitoring, to over 100 of the most significant and respected public pension funds and private institutional investors in North America and abroad.

Recently named "Class Action Law Firm of the Year" by *Global Pensions Magazine*, BLB&G also received the top ranking from *Legal 500* and *Chambers USA*, which declared that BLB&G "gives 'the best advice in the field.'" Unique among its peers, BLB&G has obtained four of the ten largest securities fraud recoveries in history and over $20 billion on behalf of investors since its founding in 1983. Working with our institutional clients, our cases have resulted in sweeping corporate governance reforms, changing deficient business practices and serving as models for public companies going forward.

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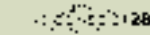

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