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Recent "F-Cubed" Decision A Chill, But Not A Death Blow, To Foreign Litigants In U.S. Courts

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The Morrison decision provides both guidance and challenges to foreign litigants who wish to bring securities claims in the U.S. against foreign companies relating to securities purchased on a foreign exchange.

In our last issue of the European *Advocate*, we discussed the jurisdictional obstacles that European litigants may face in American courts, including whether American courts have jurisdiction over claims brought by foreign investors who purchased securities of a foreign company on a foreign exchange (so called "F-Cubed" claims). Recently, the United States Court of Appeals for the Second Circuit, an influential federal appellate court based in New York, addressed this issue for the first time in *Morrison v. National Australia Bank Ltd.,* No. 07-0583-cv, 2008 WL 4660742 (2nd Cir. Oct. 23, 2008). In *Morrison*, the Second Circuit substantially narrowed the circumstances in which it would hear F-Cubed claims, while rejecting calls by the defendants to establish a clear standard that would have barred such claims when the conduct at issue has no effect in the United States. As Columbia Law School Professor John Coffee put it, the *Morrison* decision was "a chill, but not a death blow" to F-Cubed lawsuits.

In this article, we take a look at the *Morrison* decision and its implications for European and other foreign litigants seeking to bring F-Cubed claims in U.S. courts. We note that the *Morrison* decision has no impact on whether European or other foreign investors can bring securities claims against American companies.

Background

In *Morrison*, three Australian plaintiffs sought to bring securities fraud claims against National Australia Bank ("NAB"), an Australian company, and its wholly owned U.S. subsidiary HomeSide Lending Inc. ("HomeSide") on behalf of a class of foreign investors who had purchased shares of NAB on foreign exchanges. Their complaint alleged that HomeSide had deliberately inflated its financial assets; that NAB incorporated HomeSide's fraudulent financials into its financial statements; and that NAB disseminated this fraudulent information to investors through its annual reports and press releases issued in Australia, even after NAB learned about HomeSide's fraud. When the fraud was revealed, NAB wrote down its assets by $2.2 billion, causing its stock to fall significantly. The district court dismissed plaintiffs' claims, concluding that it lacked subject matter jurisdiction or the power to hear them. The plaintiffs appealed this ruling to the Second Circuit.

The Second Circuit began its opinion by affirming its "conduct" and "effects" standard for determining whether F-Cubed claims should be heard in the U.S. Under this standard, courts will hear F-Cubed claims if the foreign defendant's "conduct" in the United States was "more than merely preparatory to the fraud" and "directly caused losses to foreign investors abroad," or if the foreign defendant's conduct had a "substantial effect" in the U.S. or upon U.S. citizens. In affirming this standard, the

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Second Circuit rejected a proposal from the U.S. Securities and Exchange Commission ("SEC") that it adopt a new standard, which would simply ask whether "the conduct in the United States is material to the fraud's success and forms a substantial component of the fraudulent scheme."

The plaintiffs claimed that they met this standard because HomeSide's conduct in the U.S. was the crux of the fraud. Specifically, they argued that HomeSide had deliberately inflated its financials in the U.S., that NAB had simply incorporated HomeSide's fraudulent financials into its financial statements and press releases; and that it was HomeSide's fraudulent information that constituted the misleading information that NAB passed on to its investors. The defendants claimed that HomeSide's conduct was merely preparatory to the fraud because NAB was responsible for making the statements at issue; that NAB had both prepared and made the misleading statements abroad. In addition, the defendants urged the Second Circuit to adopt a clear standard that would bar F-Cubed securities claims whenever (as here) the alleged misstatements had no substantial effect in the U.S. or upon U.S. investors.

The Second Circuit rejected defendants' call for a strict standard, stating that it "would conflict with the goal of preventing the export of fraud from America." However, the Second Circuit agreed with defendants that HomeSide's conduct was "merely preparatory to the fraud." The Second Circuit found it significant that NAB (not HomeSide) was charged with accurately reporting to shareholders and the financial community, and that HomeSide did not communicate its falsified financials directly to investors, but rather to NAB, who in turn communicated these falsified figures to investors — a sequence that the Second Circuit referred to as a "lengthy chain of causation between the American contribution to the misstatements and the harm to investors."

Implications of the *Morrison* Decision

As noted above, *Morrison* does not affect the ability of European or other foreign litigants to bring securities claims against American companies. *Morrison* does, however, provide both guidance and challenges to foreign litigants who wish to bring securities claims in the U.S. against foreign companies relating to securities purchased on a foreign exchange. Foreign investors seeking to bring F-Cubed claims in the Second Circuit under the "conduct" test will now need to demonstrate that the foreign defendant (or an affiliated defendant) made statements in the U.S. that directly caused losses to foreign investors. Because the Second Circuit has made it more difficult for foreign investors to satisfy the "conduct" test, we expect to see future foreign litigants increasingly try to meet the "effects" test, which requires foreign investors to demonstrate that the foreign defendant's conduct had a substantial effect in the U.S. or on U.S. investors.

We also expect foreign litigants bringing F-Cubed claims in other federal circuits to push those courts to adopt the SEC's proposed jurisdictional test — whether the conduct in the United States is material to the fraud's success and forms a substantial component of the fraudulent scheme — as the governing standard. Although the Second Circuit is an influential Court of Appeals, its decisions do not bind any other federal Court of Appeals, and the fact that the U.S.'s primary securities regulator has endorsed this test (which is more expansive than the one adopted by the Second Circuit in *Morrison*) enhances the likelihood that it will be adopted by other federal Courts of Appeals.

For further information or a copy of this decision, please contact Beata Gocyk-Farber (+1 212 554 1421 or beata@blbglaw.com)

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