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FOR INSTITUTIONAL INVESTORS

Foreign Investors and US Courts

Will the Investor Protection Umbrella Continue to Reach Across Borders?

By Bruce Bernstein

In previous editions of *The Advocate*, we discussed the US Second Circuit Court of Appeals' decision in *Morrison v. National Australia Bank*, 547 F.3d 167 (2d Cir. 2008) ("NAB"). In that case, the Second Circuit (a highly influential appellate court) substantially narrowed the circumstances in which it would hear securities claims brought in a private lawsuit by foreign investors who purchased securities of a foreign company on a foreign exchange (so-called "F-cubed claims"). On November 30, 2009, the United States Supreme Court agreed to review the Second Circuit's decision in NAB — against the recommendation of both the United States Solicitor General (the "Solicitor General") and the Securities and Exchange Commission (the "SEC").

In this article, we discuss the issues raised in, and potential ramifications for foreign investors of, the Supreme Court's review of the NAB decision. The Supreme Court's decision could present obstacles for European investors in certain federal securities cases that they may choose to bring in US courts. With that in mind, we also look at proposed legislation independently pending in the United States Congress, which was proposed in response to the current economic crisis and could extend the extraterritorial application of the United States securities laws, and potentially moot the Supreme Court's decision in NAB.

Background On NAB

The NAB class action was brought in New York on behalf of non-US investors who purchased ordinary shares of National Australia Bank (an Australian corporation) on the Australian stock exchange. The complaint alleged that NAB violated the US securities laws by disseminating materially false and misleading financial statements incorporating fraudulent accounting information from one of the Company's US subsidiaries, HomeSide Mortgage Corp. ("Home-

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Side"), based in Florida. The defendants moved to dismiss the action, arguing that the court lacked jurisdiction to hear the claims. The district court agreed and dismissed the case.

The plaintiffs appealed to the Second Circuit. In considering the extraterritorial reach of the US securities laws, the Second Circuit has traditionally used two tests: (i) the "conduct test," which looks at the extent to which the allegedly fraudulent conduct occurred in the United States; and (ii) the "effects test," which asks whether the alleged conduct affected US investors and markets. The plaintiffs in NAB did not argue that the fraud had any effects on US investors or markets, so the Second Circuit analyzed the issue under the "conduct test" only. Specifically, the Second Circuit analyzed whether HomeSide's alleged manipulation of its finances, and subsequent reporting of those numbers to NAB's headquarters in Australia, constituted "the heart of the alleged fraud."

In finding that it lacked jurisdiction, the Second Circuit rejected plaintiffs' argument that the fraud occurred primarily in Florida because HomeSide was located in Jacksonville, and it was where several employees and top executives at HomeSide had been cooking its books. The Second Circuit concluded that that the actions by NAB executives in Australia (including filing the financial statements at issue, making other public statements on behalf of the company, and dealing with the company's investors) were significantly more central to the fraud and more directly responsible for harm to investors than HomeSide's accounting irregularities. Accordingly, the Second Circuit held that the subject conduct within the United States was merely "preparatory" to the fraud. The Second Circuit also noted that the "striking absence of any allegation that the alleged fraud affected American investors or America's capital markets…weighs against [its] exercise of subject matter jurisdiction."

Courts in other circuits examining "F-cubed" cases have used a similar analysis to determine whether foreign plaintiffs are protected by US securities laws. Courts, however, have differed as to how much conduct must occur in the US. before American law applies. Some courts have required only that at least some activity intended to further a fraudulent scheme occur within the United States. Other courts, such as the Second Circuit, have required that the conduct in the United States be more than merely preparatory to the fraud, and actually be a direct cause of the loss in question. Other courts have suggested that they would prefer a "bright-line rule" that forbade "F-cubed" lawsuits altogether — a position that NAB took before the Second Circuit.

LEGISLATIVE/REGULATORY AND JUDICIAL UPDATES AND DEVELOPMENTS OF INTEREST TO EUROPEAN INVESTORS

By Katherine Sinderson

UK and US Impose Taxes on Banks

The British government announced in early December 2009 that it would place a 50 percent tax on banker bonuses of more than £25,000, or about $40,700. The one-time tax will affect all banks, whether or not they received government funds and regardless of whether the bank is a British bank or a London subsidiary of a foreign bank. In response, on January 19, 2010, Credit Suisse Group AG became the first bank to publicly announce that it would target its London office for significant reductions in bonus awards to avoid the one-time tax.

In January 2010, the US announced a multiyear tax—titled the Financial Crisis Responsibility Fee—that would raise $90 billion from financial institutions over 10 years. Swedish Finance Minister Anders Borg called on his counterparts in the European Union to impose a US-style tax on the finance industry.

>> *http://www.nytimes.com/2009/12/10/business/global/10pound.html*
>> *The Wall Street Journal, January 20, 2010*

Dutch Pension Fund Prevails In Suit Over Lehman Investment

A Dutch court has ordered State Street Global Advisors to pay €40 million to Stichting Pensioenfonds Yara Nederland in a lawsuit related to losses suffered as a result of the collapse of Lehman Brothers. The fund alleged that State Street invested more than €40 million in a European unit of Lehman Brothers Holdings Inc. without informing the fund, and now the money is frozen in bankruptcy proceedings. According to the fund, the recovery represents "an important step" to recovering lost assets that represent approximately a quarter of its total assets. The fund is waiting for a ruling in a similar case currently before a US court.

>>*https://www.bloomberglaw.com/link/load/DOCUMENT/KV5LJC0YHQ0X*

Against this backdrop, plaintiffs-shareholders filed their petition for *certiorari* (petition for review) with the Supreme Court, which has discretion to hear an appeal, particularly if there is disagreement among the lower courts as to the proper interpretation of a federal statute that concerns an important matter.

The Solicitor General Urges the Supreme Court to Deny the Petition

In response to the petition, the Supreme Court requested that the Solicitor General, which represents the US government before the Court, submit a brief to express its views on whether the Court should hear the matter. In its brief, which the SEC joined, the Solicitor General contended that the issue of whether the alleged wrongdoing occurred in whole or in part outside of the United States is irrelevant to the question of whether a US court has subject matter jurisdiction to adjudicate a matter because US courts have subject-matter jurisdiction in all civil actions arising under the Constitution, laws, or treaties of the United States. The relevant question, the Solicitor General argued, concerned the interpretation of the securities laws: in particular, whether and when they should be applied extraterritorially.

The Solicitor General contended that, in NAB, the alleged fraud did not call for the extraterritorial application of the US securities laws. The Solicitor General asserted that while HomeSide (NAB's American subsidiary) may have engaged in accounting improprieties that violated the US securities laws, purchasers of NAB stock, which was listed on the Australian Exchange, could not bring a viable private action because the link between HomeSide's alleged falsehoods and the ultimate financial injury suffered by NAB shareholders was "too indirect to support liability in a private suit." The Solicitor General argued that while NAB shareholders could not bring a private lawsuit, the SEC might be able to bring a civil enforcement action because it is not required to show either reliance or damages in such a suit. In conclusion, the Solicitor General urged the Supreme Court to decline hearing the appeal on the ground that, in NAB, the "petitioners had cite[d] no decision indicating that another circuit would have allowed the [case] to go forward."

Although the Supreme Court has issued a number of opinions concerning the extraterritorial application of certain US statutes, it has never done so with respect to the US securities laws. As in previous matters, the Court will likely conduct its analysis by looking to the text of the US securities laws and its legislative history to determine whether Congress intended for extraterritorial application of the securities laws.

BLB&G Files *Amicus Curiae* Brief

In light of the important issues to be addressed in NAB, on January 26, 2010, BLB&G jointly filed an *amicus curiae* ("friend of the court") brief with two other firms on behalf of numerous foreign institutional investors with collective assets of more than $1.8 trillion. The brief advocates that the Supreme Court adopt a standard that would permit meritorious F-cubed claims to be litigated in the United States when the transnational fraudulent scheme included a material domestic component. A copy of the brief can be found at: www.blbglaw.com/misc_files/NABBrief.

The Issue Before the Supreme Court

Notwithstanding the Solicitor General's recommendation, on November 30, 2009, the Supreme Court granted the petition for *certiorari*. The central question that the Court agreed to hear on appeal is whether the judicially implied private right of action under Section 10(b) of the Exchange Act should be extended to permit fraud-on-the-market claims by a class of foreign investors who purchased foreign stock issued by a foreign company on a foreign securities exchange. Accordingly, the Supreme Court's decision has the potential to preclude foreign investors from seeking legal redress for fraud-related losses even when they are, in some significant way, related to wrongful corporate activity occurring in the United States.

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what "extraterritorial application" even means where there is substantial domestic conduct.

The Supreme Court heard oral argument on March 29, 2010 and is expected to render a decision by the end of the Court's current term in June 2010.

Proposed Congressional Legislation to Expand the US Securities Laws

On December 12, 2009, the United States House of Representatives passed The Wall Street Reform and Consumer Protection Act (the "Act"), which seeks to formalize the extraterritorial application of the US securities laws and would likely moot the issues presented by NAB. As stated in its legislative history, the Act is designed to apply to "transnational securities frauds," i.e., securities frauds in which not all of the fraudulent conduct occurs within the United States and not all of the wrongdoers are located domestically." Specifically, the Act includes language that makes clear that jurisdiction exists under the US securities laws if the allegedly wrongful conduct occurred either:

- Within the United States and constituted significant steps in furtherance of the violation, even if the securities transactions occurred outside the United States and involves only foreign investors; or
- Outside of the United States but had a foreseeable substantial effect within the United States.

Accordingly, in its current form, the Act is similar to the most expansive "conduct test" applied by the courts, which, as noted earlier, requires that at least some activity designed to further a fraudulent scheme occur within the United States. This test is also consistent with the Second Circuit's previous sentiment that Congress would not want the United States to become a base for fraudulent activity harming foreign investors. These provisions would apply to both private civil litigation (e.g., securities class and direct actions brought by institutional investors), as well as enforcement actions by the SEC.

Whether the Act will ultimately become a law, however, is not clear. There is no guarantee that the United States Senate, which must also pass the Act for it to become a law, will approve the proposed legislation in its current form, or at all. If the Senate passes a different version of the proposed legislation passed by the House, the two versions will then be sent to a conference committee where members of the Senate and House will work on reconciling the two bills into a final version. Accordingly, the ultimate fate of the Act, and its provisions concerning extraterritorial application of the securities laws, should become clearer in the coming months.

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