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American securities class actions - the future of European litigants in US courts

Executive summary

This article discusses the advantages of American securities class actions and recent jurisdictional and other obstacles to European litigants in US courts. It also discusses alternative strategies for efficient resolution of global securities class actions.

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Introduction

With increasing globalisation of the capital markets, American securities class actions are becoming more popular 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 (US) from 1999 to 2007. That number is expected to grow. Although various European jurisdictions are in the process of adopting their own class or group action procedures, the US - with its broad discovery procedures and potentially large jury verdicts - remains the preferred forum. The US courts, however, do not seem to share the same enthusiasm about becoming a forum for global securities class actions. Indeed, recent decisions seem to indicate a shift in US courts to limit their jurisdiction to predominantly American disputes. This article examines the legal obstacles that foreign litigants may encounter in the US as well as solutions and alternative strategies for efficient resolution of international securities fraud claims.

The advantages of the US courts for securities plaintiffs

The US has long provided an attractive forum for foreign plaintiffs, particularly in securities litigation. As an initial matter, US securities laws provide a well developed legal framework for resolution of cases based on securities fraud or corporate malfeasance. Moreover, American civil procedure offers a relatively plaintiff-friendly forum. For example, in the US:

- securities plaintiffs have a right to jury trial, which may result in very large money awards to plaintiffs
- securities cases can be resolved through so called opt out class actions e.g. actions which include and bind passive class members unless they affirmatively opt out of the class; by contrast, European class or group action procedure require class members to affirmatively act to opt into the class
- securities plaintiffs in the US have unprecedented access to evidence through broad discovery process

Furthermore, the US system allows for a contingent legal fee structure, which means that lawyers representing the plaintiffs assume all the costs and risks of the litigation (frequently millions of dollars), and are only compensated from a portion of the assets recovered, if any. 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 UK.

Finally, US securities laws recognize a 'fraud-on-the-market' presumption. The fraud-on-the-market presumption assumes that in an open and developed securities market the price of a security is determined by available material information regarding the issuer and its business. Thus, an investor who purchases a security in an efficient market is presumed to have relied on public information about that security. This type of presumption is not recognised by any European jurisdiction, making proof of reliance on class basis very difficult.

As noted above, however, a recent trend in US courts suggests that foreign plaintiffs may have a more limited access to US forum in future proceedings.

Procedural obstacles to foreign litigants

Subject matter jurisdiction

To resolve a case, a US court must possess a subject matter jurisdiction over the dispute pending before it. In actions involving trans-national securities fraud claims - for example, actions against foreign issuers - the US courts developed 'conduct' and 'effects' tests to ascertain whether there is sufficient nexus to the US to justify the exercise of jurisdiction by an American court.

The 'conduct test' considers to what extent the alleged fraudulent conduct occurred in the US. The 'effects' test considers whether illegal activity abroad caused a substantial adverse effect within the US, either on American investors or on American securities markets. To satisfy the conduct test, the conduct by a foreign issuer or its officers in the US cannot be "merely preparatory" to a fraudulent scheme, but, rather, it 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 US 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. While the conduct test is a very fact-specific inquiry, the recent trend suggests reluctance by federal courts to assert jurisdiction over claims that are brought by or on behalf of F-Cubed plaintiffs unless the US conduct is particularly strong. American investors or foreign investors who purchased securities on US 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.

Thus, 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 Securities Litigation*), courts dismissed claims brought by F-Cubed investors based on lack of sufficient US conduct, but sustained claims of American investors or foreign investors who purchased securities on US exchanges.[1]

Superiority and judgment non-recognition

Another obstacle to foreign plaintiffs in US courts comes from judicial interpretation of procedural rules relating to class actions. Unlike the subject matter jurisdiction inquiry, this issue comes up only in connection with class actions involving not individual suits.

The Federal Rules of Civil Procedure set out several criteria that must be satisfied for a class action to proceed. One of those criteria is that a class action be a superior (i.e., most efficient) method of resolving the case. Defendants in securities class actions involving trans-national disputes challenged the superiority of US class action mechanism because foreign courts might not recognize the judgment of US courts. If a judgment of US court is 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 mechanism as the most efficient means to resolve the dispute.

The US courts disagree as to which foreign plaintiffs, if any, should be excluded from US class actions based on this argument. For example in *Bersch Securities Litigation*, the court excluded investors from England, Germany, Switzerland, Italy and France from the class. More recently, however, in *Vivendi Securities Litigation* the court allowed the English, French and Dutch plaintiffs to stay in the class, but excluded German and Austrian investors. In yet another case addressing this issue, *Cromer Finance Limited Securities Litigation*, the court applied a more lenient standard, and allowed all foreign investors (including those from Germany) to stay in the class. Finally, some courts take the position that non-recognition of a judgment should not be used to decline class certification altogether, as in *Lloyd's American Trust Fund Litigation*.

Global presumption of reliance

Perhaps the most dangerous obstacle to F-cubed plaintiffs in the US comes from a recent decision in *Astrazeneca Securities Litigation*. In *Astrazeneca*, the court declined to extend the fraud-on-the-market presumption to claims of foreign investors, holding that US law does not recognise a 'global' fraud-on-the-market presumption. Without this presumption, foreign class plaintiffs could not sufficiently allege reliance upon the same publicly available information as US plaintiffs and could not show that the issuer's conduct directly caused their loss.

Solutions

Foreign investors dismissed from US class actions may have alternative means to pursue their claims depending on the reasons for dismissal.

1. The trend to dismiss claims by F-Cubed investors based on lack of US conduct—though seemingly increasing—should not be overestimated. The conduct test is a very fact-intensive inquiry and sufficient US conduct was found in numerous cases against foreign issuers, including in Vivendi Securities Litigation, In re Royal Ahold Securities Litigation, Cable & Wireless Securities Litigation and Alstom Securities Litigation.

Individual actions

Foreign investors who were dismissed from US class actions based on judgment non-recognition argument may chose to file individual suits in the US provided that they can allege sufficient US conduct to establish subject matter jurisdiction. As noted above, the non-recognition of judgment argument is relevant only in the context of assessing the superiority of a class action as a mechanism to resolve the dispute. In the context of an individual case, no such analysis applies. Indeed, after foreign plaintiffs were recently excluded from the *Vivendi* securities class action, they filed numerous individual cases in the United States, which are still pending.

Dutch Act on Collective Settlements

Foreign investors who were excluded from US class action based on lack of subject matter jurisdiction have a more difficult road ahead. Individual actions by those investors will obviously be subject to the same jurisdictional challenges. One potential solution lies in the Dutch Act on Collective Settlement of Mass Damages, a 2005 Dutch law which allows a US-style settlement for all members of the class who do not affirmatively opt out of the settlement. Since the Act provides only for US-styled settlements and *not* for initiation of a US-styled class action, it has been used to settle civil class action suits initiated in the US on behalf of foreign investors who were excluded from the class in US 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 I*n re SCOR Securities Litigation* - who were excluded from the US class action for lack of subject matter jurisdiction - announced 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 before the Dutch Court of Appeals and other settlements, like SCOR, are being filed in the Netherlands, many wonder whether the Netherlands will become a new Mecca for global class actions if the US courts continue to decline the honor.

European actions

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

Conclusion

With the globalisation of our economy, securities class actions are no longer a US 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 US 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 their portfolios and developments in US courts. In some cases, passive reliance on US class action settlements may no longer be enough to recoup investment losses.

Key messages

- The well-developed legal system in the US provides an attractive forum for foreign investors to pursue securities fraud claims
- European involvement in US securities class action litigation is on the rise
- Recent US court decisions have created obstacles for foreign investors seeking to participate in US securities class action litigation
- Solutions to US securities class action litigation obstacles include:
  - pursuing individual actions in the US
  - the Dutch Act on Collective Settlement of Mass Damages
  - pursuing European actions
- These recent obstacles to US securities class action litigation demands that European investors actively monitor developments in US courts

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