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A border battle over lawsuits

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"Foreign-cubed" is the name of the latest legal nemesis that keeps lawyers for companies ranging from Toyota to Vivendi up at night.

The term refers to securities class action litigation in which the investors are foreign, the issuers are foreign and the fraudulent conduct took place on foreign soil. And yet, because of some company tie to the United States, large or minuscule, they end up in U.S. courts, where plaintiffs usually can do a lot better than if the suits were filed abroad.

Six years after the moniker was first coined, a foreign-cubed suit has made its way to the U.S. Supreme Court, which will hear the case, *Morrison v. National Australia Bank*, on March 29. Foreign investors accused Australia's largest bank of fraud involving a Florida subsidiary, but the bank insists all of the disputed activity took place in Australia. So far, the bank has won.

Foreign companies and countries have flooded the Court with friend of the court briefs, signaling the importance of the case worldwide. Even parties litigating over the Toyota safety meltdown are watching; several securities class actions have been filed in federal courts against the company, which trades on the Tokyo Stock Exchange, based on statements made by Toyota officials in Japan.

The case comes to a Court that has grown increasingly skeptical about U.S. courts exerting extraterritorial jurisdiction. In the 2007 case *Microsoft v. AT&T*, a 7-1 majority spoke approvingly of the presumption that "United States law governs domestically but does not rule the world." Three years earlier, in *Hoffman-LaRoche v. Empagran*, a unanimous Court said extending the reach of American antitrust laws too far into foreign situations would be "an act of legal imperialism."

EXPORTING U.S. LAW?

There is broad concern on the Court and overseas about "the exporting of American law," said Andrew Pincus, a Mayer Brown partner in Washington who authored a brief for the International Chamber of Commerce and other foreign business associations. Other countries have their own well-developed ways of dealing with fraud, so Pincus wrote in his brief that "applying U.S. law to deceptive devices or contrivances that occur abroad, effectively trumping non-U.S. policy choices, significantly undermines comity." France, for example, relies on government enforcement, not private suits, and class actions are unavailable altogether in Germany. Fraud-on-the-market claims are unheard of in many countries, but not in the United States.

Domestically, critics have voiced another concern about foreign-cubed: Exposing foreign companies to class actions in the United States based merely on the existence of an American subsidiary or listing on a U.S. exchange will discourage foreign investment here.

"There could be severe economic consequences," said Robin Conrad, executive vice president of the National Chamber Litigation Center, the U.S. Chamber of Commerce's public policy law firm. "Foreign companies will de-list from American exchanges and our position as the economic capital of the world will be threatened."

She said foreign companies are "scared to death" about U.S. class actions and many joined to file briefs in the Morrison case. Most have called on New York law firms to file briefs, giving the case a Manhattan profile before a Court that is used to hearing from Washington-based Supreme Court specialists. "The briefing is top-heavy with New York firms," Conrad said. "Companies involved in the foreign markets are accustomed to looking to the New York law firms."

Most notable among foreign companies filing, she said, is Vivendi, the French communications firm that was hit with a securities class action in New York in 2002. The company, whose common stock is not listed on any U.S. exchange, challenged the suit on jurisdictional grounds. It lost, and a U.S. jury in January returned a verdict that could cost the company more than \$9 billion.

The Australia case could have a "substantial impact" on the ultimate outcome of the Vivendi appeal and others currently pending, said Ira Feinberg of Hogan & Hartson's New York office, who filed a brief for Vivendi and other European companies facing suits in U.S. courts.

Plaintiffs' lawyers have countered that the parade of horrors is overblown. "We are confident the Court will cut through any rhetoric with respect to this matter and will analyze it carefully in light of the competing interests and the factual allegations," said Thomas Dubbs of Labaton Sucharow in New York, who will argue for the Australian plaintiffs before the high court.

Another plaintiffs'-side brief in the case argues that banishing foreign-cubed class actions would turn the United States into a safe haven for securities fraud.

"Without this protection, perpetrators of securities fraud within the United States are able to 'export' the consequences of their misdeeds with little or no risk of being held responsible," said Allyn Lite of Lite DePalma Greenberg in Newark, N.J., in a brief for two Australian investor groups.

In the case before the high court, Australian plaintiffs claim that U.S.-based officials of the bank's Florida subsidiary HomeSide Lending, a mortgage service company, overvalued its mortgage portfolio in 1998. Those officials transmitted the fraudulent information back to Australia, misleading shareholders in that country. Eventually, company officials resigned and the bank announced writedowns totaling more than 3 billion Australian dollars.

"The fraudulent scheme occurred in Florida," Dubbs asserted in his brief. But the U.S. District Court for the Southern District of New York found otherwise, ruling in 2006 that its jurisdiction was limited to securities transactions in the United States.

The U.S. Court of Appeals for the 2d Circuit affirmed in 2008 on the ground that the Australian company's actions within the United States did not "directly cause" the harm to the aggrieved investors. The Australian headquarters office was responsible for statements to investors, the panel ruled — even though it acknowledged that the Florida subsidiary "may have been the original source of the problematic numbers." The ruling by Judge Barrington Parker also noted the "striking absence" of evidence that the fraud affected American investors or markets.

The appeals panel concluded, "We are an American court, not the world's court, and we cannot and should not expend our resources resolving cases that do not affect Americans or involve fraud emanating from America." Other members of the panel were judges Jon Newman and Guido Calabresi. Justice Sonia Sotomayor, who was a 2d Circuit judge at the time of the decision, has recused from considering the case at the Supreme Court.

THE U.S. CONNECTION

The issue before the high court will be the standard used for assessing whether a suit has enough of a U.S. connection to justify jurisdiction in foreign-cubed suits.

On that point, there is an odd alignment among the parties.

At earlier stages in the case, the U.S. Securities and Exchange Commission sided with the plaintiffs in asserting that U.S. courts had jurisdiction over the Australia bank dispute. But at the Supreme Court, the solicitor general filed a brief siding with the defendant bank, urging the Court to adopt a standard that would exclude the Australia bank litigation.

But the bank, even though it won under the 2d Circuit standard and could win if the solicitor general's standard were adopted, would just as soon use neither. Criticizing the "we-know-it-when-we-see-it jurisprudence" that has evolved in foreign securities cases thus far, the bank's lawyer, George Conway III of Wachtell, Lipton, Rosen & Katz, urges a bright-line rule that rules out foreign-cubed cases involving foreign harms and foreign securities altogether.

"Why should American law supplant Australian's own determination about how best to protect Australian investors from allegedly fraudulent conduct engaged in significant part by an Australian company?" asked Conway in his brief. Conway will argue the case for the bank on March 29.

The plaintiffs, for their part, are urging the high court to adopt the solicitor general's proposed standard — even though the solicitor general sided with the bank. Under the government standard, U.S. courts would have jurisdiction over foreign-cubed cases if the company's disputed conduct in the United States was "material to the fraud's success."

Most of all, says Marc Gottridge, managing U.S. partner of Lovells in New York, foreign companies are looking for an end to the array of subjective and confusing standards that now determine when they have to face securities suits in the United States.

"Has there been a flood of hundreds of cases? No there has not," said Gottridge, who represents numerous foreign firms but none involved in the case before the Court. "But what you have now is chaos. You can't have litigation going on for years and still not know if the case even belongs in court. We hope the Court will put the confusion to rest."

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