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# Global Realm of **Securities** Class Actions

*As U.S. courts grapple with jurisdiction over foreign investors' claims, other countries adopt elements similar to American model.*

BY JOHN J. CLARKE, JR.  
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EVERY DAY, the financial pages confirm that our economy is not just becoming global; it already is global. Litigation's international expansion has kept pace, with a noticeable increase in the frequency of overseas investors appearing as plaintiffs in securities class actions in the United States. As our courts more carefully define the limits of their subject matter jurisdiction in those cases, however, a growing list of nations in Europe and elsewhere are adopting procedures akin to American-style class actions.

This article discusses developments in these two related areas. Specifically, it will: (1) discuss the developing standards for subject matter jurisdiction over claims by foreign investors in U.S. courts; and (2) review the evolution of the class action device for securities claims in other jurisdictions, including a recent Dutch settlement that suggests a potential strategic advantage for dual-listed companies presented by one such statutory framework.

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### Subject Matter Jurisdiction

Neither the Securities Act of 1933 nor the Securities Exchange Act of 1934 speaks to its extraterritorial application. In actions involving transnational securities fraud claims, courts instead evaluate their subject matter jurisdiction under the judicially crafted "conduct" and "effects" tests,<sup>1</sup> that is, "whether the wrongful conduct occurred in the United States, and...whether the wrongful conduct had a substantial effect in the United States..."<sup>2</sup>

Conduct by a foreign issuer or its officers in the United States will not be sufficient to support subject matter jurisdiction if that conduct was "merely preparatory" to a fraudulent scheme; instead, U.S. conduct must have "directly caused" the claimed losses.<sup>3</sup> Similarly, the required domestic "effects" of extraterritorial conduct are those that "result[ed] in injury to purchasers or sellers of those securities in whom the United States has an interest [i.e., securities traded on U.S. exchanges], not where acts simply have an adverse effect on the American economy or American investors generally."<sup>4</sup>

These standards are implicated when investor plaintiffs assert claims against foreign private issuers having shares that are dual-listed on a foreign exchange and in the United States. In those cases, where a foreign plaintiff made purchases or sales of the dual-listed issuer's securities on a U.S. exchange, the subject matter jurisdiction analysis should be similar to

the analysis for an investor who is based in the United States. In contrast, claims brought by so-called "foreign cubed" investors test the limits of federal subject matter jurisdiction.<sup>5</sup>

"Foreign cubed" investors reside outside of the United States and have purchased securities of a foreign issuer on a foreign exchange. Increasingly, federal courts have concluded that they do not have subject matter jurisdiction to consider the claims of these investors, whether individually or as part of a larger class that includes U.S. purchasers. Federal subject matter jurisdiction exists over claims of foreign cubed investors only when "acts...within the United States directly caused such losses."<sup>6</sup>

In *Royal Dutch/Shell Transport Securities Litigation*, for example, the district court recently dismissed claims brought on behalf of foreign cubed investors because the allegedly fraudulent acts were centered in London and various conduct in the United States was not essential to the accounting misstatements at issue. A much smaller class composed of only those investors who purchased or sold shares on exchanges in the United States was permitted to proceed.<sup>7</sup> A number of other courts have found that they lacked subject matter jurisdiction in securities fraud cases that involved similar facts—a foreign private issuer with little presence in the United States and an alleged fraud that did not involve any substantial U.S. conduct.<sup>8</sup>

Nevertheless, courts have found subject matter jurisdiction in other cases alleging substantial U.S.-based conduct. For example, in *In re Vivendi*

*Universal S.A. Sec. Litig.*, Vivendi's acquisition of several companies headquartered in the United States was the focus of the allegedly fraudulent scheme and the two most senior officers of Vivendi had moved part-time to New York to be available to Wall Street analysts.<sup>9</sup> In *In re Royal Ahold NV Sec. Litig.*, 80.5 percent of the \$1.1 billion earnings restatement at issue related to accounting for a U.S. subsidiary.<sup>10</sup> In *In re Cable & Wireless PLC Sec. Litig.*, the defendant had entered into allegedly fraudulent capacity swap transactions from its office in Virginia.<sup>11</sup> And in *In re Alstom SA Sec. Litig.*, the United States was the locus of activity for one of plaintiffs' three alleged fraudulent schemes.<sup>12</sup>

While it is clear that subject matter jurisdiction is a fact-intensive inquiry, the recent trend suggests some reluctance by federal courts to assert jurisdiction over claims of securities fraud that are brought by (or on behalf of) foreign cubed plaintiffs. Given the importance of U.S. conduct in the analysis, global corporations with substantial operations in the United States, particularly those with accounting or corporate finance functions located here, may be more exposed to U.S. securities litigation than companies whose principal contact with the United States is the issuance of securities on American exchanges.

### Class Action Device Outside U.S.

For overseas investor plaintiffs, the United States clearly remains the most hospitable jurisdiction in which to assert claims of securities fraud. The structural advantages offered in the United States for this type of claim include: trial by jury; robust pretrial discovery; the "fraud on the market" presumption of reliance; the "opt-out" form of class action; an established securities plaintiffs' bar; contingency fees; and a tradition not to shift attorney's fees in favor of the prevailing party.

Nevertheless, within the past several years, a number of nations have adopted procedural mechanisms similar to the U.S. class action in important respects, including Australia, Canada, Denmark, Finland, France, Germany, Israel, Italy, the Netherlands, Norway, Portugal, South Korea, Spain, Sweden and the United Kingdom (England and Wales). Because of the perceived abuses of the American system, no other nation has embraced our model in all respects. However,

the laws of several of these nations merit attention because of their potential for litigation of complex securities claims.

**Australia.** The Australian system for investor class actions appears to most closely resemble the form of securities class actions in the United States. A number of issuers are facing class actions in Australia that allege misrepresentations or omissions to investors, with the A\$97 million class settlement by GIO Insurance Ltd. representing a particularly noteworthy result.

The Australian model permits class actions to be brought by representative plaintiffs based on standards that are similar to those under Federal Rule of Civil Procedure 23 (although no formal motion for class certification is required). As in the United States, class claims in Australia may

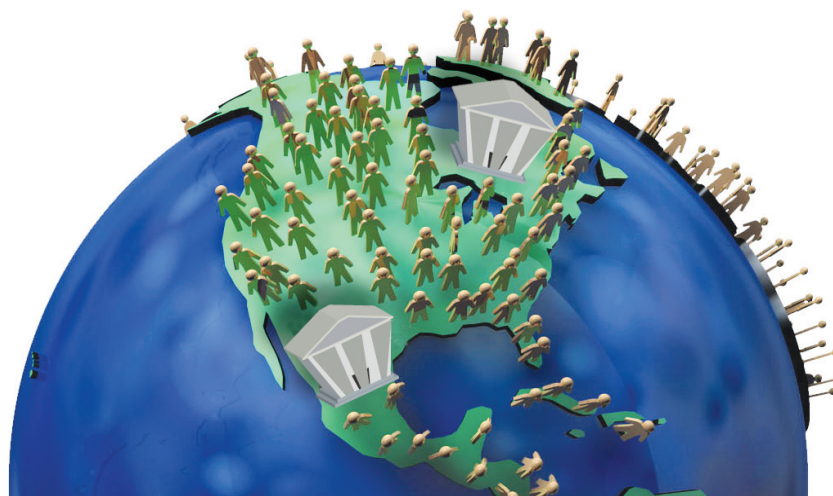
**Canada.** Canadian law also permits investor class actions. Under the Ontario Securities Act, investors have long had a private right of action for damages or rescission based on false or misleading statements that were made in a prospectus, an offering memorandum or a takeover proposal circular, referred to as "primary market" disclosures. In those actions, the plaintiff's reliance is presumed once a misrepresentation has been established.<sup>14</sup> Before 2006, however, class claims for false or misleading statements in the much broader secondary market—including violations in an issuer's "continuous disclosures" in annual and quarterly reports—could only be maintained under the common law and required each class member to establish reliance.<sup>15</sup>

Beginning in 2006, the Ontario Securities Act has provided for a private right of action for misrepresentations in the secondary market against issuers and other specified persons. While the statute grants class members a presumption of reliance in such actions, it also caps an issuer's damages at the greater of \$1 million or 5 percent of an issuer's market capitalization. In addition, the statute requires court approval before an action can be commenced and expressly includes a "loser pays" provision, both of which were intended to deter "strike suits," a perceived abuse of the American system.<sup>16</sup>

**England and Wales.** Since 2000, English civil litigation rules have provided for the management of "group litigation" (Scotland does not have a group litigation procedure). Unlike the American system, the law of England and Wales requires plaintiffs to opt in to the action.

The group may be represented by a lead lawyer, but individual members of the group also can have their own lawyers. The rules provide for the management of claims that give rise to common or related issues of fact or law under a Group Litigation Order. It provides for the establishment of a group register and sets out the issues that identify the claims to be managed. A managing judge is appointed and assumes overall responsibility for management of the claims.<sup>17</sup>

The unavailability of contingency fees and the "loser pays" fee shifting rule provide two substantial hurdles to the prosecution of group actions in England on a scale similar to securities class actions in the United States. A 2003 group action brought against Railtrack by




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be brought based on alleged misrepresentations to investors, but the availability of the "fraud on the market" presumption of reliance remains an open question. Class members will be considered bound by any judgment unless they opt out.

Unlike U.S. practice, Australia does not provide for jury trials of securities claims. In addition, Australia follows the "loser pays" (English) rule on fee shifting. Australian law also prohibits contingent fee arrangements, but it does permit "no win no fee" arrangements that are similar. Australia is a pioneer in third-party litigation funding arrangements that may offer a substitute to the American-style contingent fee in securities class actions (but the issue is subject to continuing debate in the courts).<sup>13</sup>

55,000 stockholders demonstrates the problem. After the court required the plaintiffs' group to post approximately £2 million (\$3.96 million) as security for the government's defense costs before trial began, approximately 6,000 plaintiffs withdrew from the litigation. Ultimately, the plaintiffs failed to establish malice, a necessary element of their claim, and a defense verdict was entered after a four-week bench trial.<sup>18</sup>

**Germany.** German law does not provide for any type of investor class action. However, effective Nov. 1, 2005, Germany enacted two laws intended to make it easier for investors to bring actions for misstatements or omissions by issuers. One of them, the Capital Investor's Model Proceeding Act (the Kapitalanleger-Musterverfahrensgesetz, referred to as "KapMuG") provides for a form of collective action for securities claims through the centralization of claims and provides for the possibility of binding test cases, referred to as model proceedings, on common issues of law or fact. Model proceedings are established if at least 10 plaintiffs file claims relating to the same matter. The "loser pays" rule applies, and contingency fees are not permitted.<sup>19</sup>

Deutsche Telekom currently is in the midst of the first KapMuG proceeding, in which a trial began in Frankfurt in early April 2008. The plaintiffs claim that in connection with a stock offering in 2000, Deutsche Telekom failed to inform investors that it planned to spend \$35 billion to acquire Voicestream in the United States and made misstatements as to the valuation of its real property. The price of the shares later collapsed. In 2005, Deutsche Telekom settled claims in the United States relating to the same alleged misrepresentations for \$120 million. The ongoing model proceeding will be binding on other plaintiffs, but even if the test plaintiffs prevail, individual proceedings on issues such as reliance and damages will still be required for each of the approximately 15,000 investor plaintiffs.<sup>20</sup>

**Netherlands.** In 1994, the Netherlands enacted legislation permitting actions by consumer associations. In May 2007, the investor association VEB successfully established in the Amsterdam Court of Appeal that a prospectus issued by World Online contained incorrect information. If the judgment withstands further appeal, affected stockholders will still be required to bring individual proceedings on reliance and damages issues (similar to the KapMuG system).<sup>21</sup>

Perhaps more significant, however, in 2005, the Netherlands Civil Code was amended by the Act on the Collective Settlement of Mass Claims. The act, originally envisioned as a method for resolving large-scale torts, provides for court-approved settlements of opt-out class actions. As

in most U.S. class actions, class members will be bound by settlements under the act unless they affirmatively act to exclude themselves.<sup>22</sup>

In 2007, the act became a resource for the dual-listed issuer Royal Dutch Shell, which was defending itself in a class action in the District of New Jersey alleging that it had fraudulently overstated its proved oil and gas reserves. In an early decision, the district court declined to dismiss the claims of non-U.S. purchasers for lack of subject matter jurisdiction, concluding that sufficient U.S. conduct had been alleged.<sup>23</sup> As a result of that decision, Royal Dutch Shell faced potential damages in the United States relating to trading in all of its outstanding shares, reflecting a total market capitalization loss of \$13.4 billion, even though only around 8 percent of those shares were traded in the United States.

To control this potentially catastrophic exposure, Royal Dutch Shell began settlement talks with the Dutch investor association, VEB, and American plaintiffs' firms that were not involved in the U.S. class action. In April 2007, those parties announced that they had reached a proposed settlement of all claims by non-U.S. purchasers for \$352 million. The settlement was subject to the approval of the Amsterdam Court of Appeal and required the U.S. court to conclude that it did not have subject matter jurisdiction over the settled claims.

After the Dutch settlement was announced, the federal court revisited and reversed the prior decision on subject matter jurisdiction, concluding that it did not have jurisdiction over claims by non-U.S. purchasers based on a review of facts developed in discovery.<sup>24</sup> As a result, the Dutch settlement may proceed. Recently, the U.S. parties reached an agreement in principle to settle all remaining claims (those of U.S. purchasers) for approximately \$83 million.

The availability of a binding, alternative system for resolution of class claims undoubtedly proved an advantage to Royal Dutch Shell. Facing potentially massive exposure in the U.S. class action, the company negotiated a consensual resolution of European claims that addressed 92 percent of its potential liability, dramatically reducing the negotiating leverage of the American lead plaintiffs. It is not surprising that a settlement of the claims that remained in the U.S. litigation followed shortly after the Dutch settlement was allowed to proceed.

In comparison, in federal securities litigation against Royal Ahold NV, also a dual-listed Dutch company, the claims of non-U.S. purchasers were included as part of a single global settlement that was overseen by a federal court in Maryland. The \$1.1 billion settlement reached in that case—covering U.S. and non-U.S. purchasers—is the seventh largest securities class action settlement of all time.

## Conclusion

As procedures continue to evolve worldwide, dual-listed companies should evaluate the nature and extent of their activities within the United States with an eye toward what a federal court might consider significant in a future analysis of subject matter jurisdiction. At the same time, those issuers should familiarize themselves with the class action environment in their home jurisdiction as part of their overall litigation risk assessment.



1. See *Bersch v. Drexel Firestone Inc.*, 519 F.2d 974 (2d Cir. 1975); *IIT v. Vencap, Ltd.*, 519 F.2d 1001 (2d Cir. 1975).

2. *SEC v. Berger*, 322 F.3d 187, 192 (2d Cir. 2003).

3. *Bersch*, 519 F.2d at 987; *Alfadda v. Femm*, 935 F.2d 475, 478 (2d Cir. 1991). See also *Zoelsch v. Arthur Andersen & Co.*, 824 F.2d 27, 31 (D.C. Cir. 1987) (U.S. conduct "comprises all the elements...necessary to establish a violation"); *Kauthar SDN BHD v. Sternberg*, 149 F.3d 659 (7th Cir. 1998) (U.S. conduct must be "material to the successful completion of the alleged scheme"); *SEC v. Kasser*, 548 F.2d 109, 115 (3d Cir. 1977) (U.S. conduct must have been "essential to the plan to defraud"); *Travis v. Anthes Imperial Ltd.*, 473 F.2d 515, 524 (8th Cir. 1973) ("significant conduct with respect to the alleged violations in the United States").

4. *Bersch*, 519 F.2d at 989; see *Interbrew S.A. v. Edperbrascan Corp.*, 23 F.Supp.2d 425, 429 (SDNY 1998).

5. See Joseph M. McLaughlin, "Foreign Investors and Securities Class Actions," NYLJ, April 10, 2008; Stuart M. Grant and Diane Zilka, "The Current Role of Foreign Investors in Federal Securities Class Actions," Practising Law Institute, September 2007.

6. *Bersch*, 519 F.2d at 987.

7. 522 F.Supp.2d 712 (D. N.J. 2007).

8. See, e.g., *In re SCOR Holding AG Litig.*, 537 F.Supp.2d 556 (SDNY March 6, 2008); *In re Rhodia SA Sec. Litig.*, 531 F.Supp.2d 527, 538 (SDNY 2007); *In re Nat'l Australia Bank Sec. Litig.*, 2006 WL 3844465 (SDNY Oct. 25, 2006); *In re Bayer AG Sec. Litig.*, 423 F.Supp.2d 105 (SDNY 2005); *Tri-Star Farms Ltd. v. Marconi PLC*, 225 F.Supp.2d 567 (W.D. Pa. 2002).

9. *In re Vivendi Universal S.A. Sec. Litig.*, 381 F.Supp.2d 158, 169-70 (SDNY 2003).

10. *In re Royal Ahold NV Sec. Litig.*, 351 F.Supp.2d 334, 357 (D. Md. 2004).

11. *In re Cable & Wireless PLC Sec. Litig.*, 321 F.Supp.2d 749, 763 (E.D. Va. 2004).

12. *In re Alstom SA Sec. Litig.*, 406 F.Supp.2d 346, 397 (SDNY 2005).

13. See Ashley Black and Kathleen Harris, "Corporate Class Actions in Australia," Malleons Stephen Jacques, June 2006 (available at [www.malleons.com/publications](http://www.malleons.com/publications)).

14. Ontario Securities Act §§130, 130.1, 131.

15. See *Carom v. Bre-X Minerals Ltd.* (1999), 44 O.R. (3d) 173 at 197 reversed (2000), 51 O.R. (3d) 263 (Ont. C.A.).

16. See Randy C. Sutton, "Securities Class Actions in Canada: The Dawn of a New Era?" Ogilvy Renault LLP (2007) (available at [www.acc.com/resource/v8352](http://www.acc.com/resource/v8352)); Ontario Securities Act §138.1, et seq.

17. See Part 19, Section III and Part 19B of the Civil Procedures Rules.

18. See Heather Smith, "Is America Exporting Class Actions to Europe?" American Lawyer, Feb. 28, 2006.

19. See Stefano M. Grace, "Strengthening Investor Confidence in Europe: U.S.-Style Securities Class Actions and the Acquis Communautaire," 15 J. Transnational L. & Pol'y 281, 299-300 (2006).

20. See Nils-Viktor Sorge, "A Historic Deutsche Telekom Case," Business Week, April 8, 2008.

21. See Chris Bates and Malcolm Sweeting, "The Creep of Class Actions Into Europe Clifford Chance Client Briefing May 2007," Practising Law Institute, January 2008.

22. Wet Collectieve Afwikkeling Massaschade, BW Art. 907-10 and 14 Rv Art. 1013-18.

23. *In re Royal Dutch/Shell Transport Sec. Litig.*, 380 F.Supp.2d 509, 540-44 (D. N.J. 2005).

24. *In re Royal Dutch/Shell Transport Sec. Litig.*, 522 F.Supp.2d 712 (D. N.J. 2007).