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Expert Analysis

Recent Developments In F-Cubed Securities Class Actions

Over the past decade, foreign investors have increasingly initiated securities fraud class actions against foreign companies in U.S. courts. These actions are often called “foreign-cubed” because they are brought in U.S. courts against foreign issuers on behalf of a class of foreign investors that purchased securities on foreign securities exchanges. Many of these purported class actions have raised interesting questions concerning the extraterritorial application of the U.S. securities laws—which are silent on the question of whether, and to what extent, their provisions apply to foreign conduct involving foreign defendants.

Over the past few months, there have been significant developments in three “foreign-cubed” cases that are pending in the Southern District of New York. First, in *In re Vivendi Universal S.A. Securities Litigation*, a jury returned a verdict in favor of U.S. and foreign shareholders from France, England, and the Netherlands who had alleged that Vivendi Universal, S.A., the French media conglomerate, made misrepresentations to the investing public in 2001 and 2002.¹

Second, in *Cornwell v. Credit Suisse Group*,² the court—in contrast to the determinations made in *Vivendi*—significantly restricted the proposed class and the scope of plaintiffs’ potential recovery by finding that it did not have subject matter jurisdiction over the claims of any foreign investors who purchased shares of Credit Suisse Group. Third, in *Copeland v. Fortis*,³ the court held that it did not have subject matter jurisdiction over the claims brought by all investors because the alleged fraudulent activity took place abroad and plaintiffs had not adequately alleged substantial “effects” in the United States.

This article provides an overview of the important jurisdictional issues raised by the *Vivendi*, *Credit Suisse*, and *Fortis* securities class actions, and the factors that led to the divergent results in those cases.

Second Circuit Standard

The U.S. Court of Appeals for the Second Circuit has “consistently looked at two factors to determine whether it had jurisdiction over securities claims asserted by foreign investors: (1) whether the wrongful conduct occurred in the United States, and (2) whether the wrongful conduct had substantial effect in the United States or upon United States citizens.”⁴ These factors

By
**Todd G.
Cosenza**



are known, respectively, as the “conduct test” and the “effects test.”⁵

In securities class actions, claims brought by foreign shareholders who purchased shares of foreign corporations on foreign exchanges generally do not satisfy the effects test. Subject matter jurisdiction over the claims of such shareholders usually turns on the application of the conduct test.

As a general guideline, the Second Circuit has found that the conduct test is met when “(1) the defendant’s activities in the United States were *more than ‘merely preparatory’* to a securities fraud conducted elsewhere and (2) the activities or culpable failures to act within the United States *‘directly caused’ the claimed losses.*”⁶ Thus,

U.S. securities laws are silent on the question of whether, and to what extent, their provisions apply to foreign conduct involving foreign defendants.

to support a finding of subject matter jurisdiction, foreign investors usually are required to demonstrate conduct in the United States of sufficient centrality to the claim of fraud to warrant an exercise of such jurisdiction.

‘Vivendi’ Class Action

In *Vivendi*, plaintiffs alleged that the company, Vivendi’s former CEO Jean Marie Messier, and former Vivendi CFO Guillaume Hannezo misled the public about Vivendi’s cash flow through their promotion of a three-way merger between Vivendi, Seagram’s entertainment businesses, and Canal Plus S.A. in December 2000. According to plaintiffs, Vivendi concealed the severity of its liquidity problems stemming from the debt load incurred as a result of that three-way merger and other transactions. After Vivendi’s board fired Mr. Messier in early July of 2002, investors brought a number of

securities class actions against Vivendi, Mr. Messier, and Mr. Hannezo in the United States.

Defendants in *Vivendi* argued that the U.S. District Court did not have subject matter jurisdiction over the claims asserted by foreign investors who acquired shares of Vivendi, a foreign corporation, on foreign stock exchanges. Prior to trial, the district court rejected that argument. Applying the conduct test, the court found that “the fraud alleged in the [complaint] was perpetrated, in important part, in the United States.”⁷ The court went on to note that a significant number of the alleged misleading statements made by the company, Mr. Messier, and Mr. Hannezo were to analysts and investors in New York. Viewing these allegations as a whole, the *Vivendi* court held that the alleged fraudulent conduct was sufficiently centralized in the United States to warrant U.S. jurisdiction.

After holding that it had subject matter jurisdiction over the foreign investors’ claims, the court then addressed whether foreign investors’ claims should be adjudicated as a class action. The court analyzed whether different foreign jurisdictions would give preclusive effect to a judgment by a U.S. court in a class action. Over strong objection from defendants, the district court concluded that the courts of France, England, and the Netherlands would likely enforce a U.S. judgment and included investors from those countries in the *Vivendi* class action.⁸ The court, however, excluded investors from Germany and Austria because it was not sufficiently certain that German and Austrian courts would respect such a U.S. judgment.⁹

The *Vivendi* trial lasted over three months. After hearing the evidence, the jury was charged with evaluating 57 allegedly false public disclosures made by the defendants from October 2000 to June 2002. The jurors concluded that each disclosure contained a material misstatement or omission and that Vivendi, but not Messrs. Messier and Hannezo, had acted “recklessly” by disseminating materially misleading information to the public.

If the verdict is not overturned, the amount of damages that Vivendi may be required to pay remains uncertain because (among other reasons) the parties presently cannot determine the total number of shares traded by class members, the dates of the relevant sales, or the number of class members who will submit a valid claim form after receiving notice of the decision. Obviously, however, this case is far from over. Vivendi has indicated that it will file several post-trial motions seeking to overturn the verdict. Should those efforts prove unsuccessful, an appeal will likely follow.

TODD G. COSENZA is a senior associate at Willkie Farr & Gallagher. He can be reached at tcosenza@willkie.com.

'Credit Suisse' Class Action

In *Credit Suisse*, plaintiffs brought securities law claims premised on allegations that Credit Suisse, a Swiss corporation, and certain of its directors and officers failed to record losses relating to the deterioration in the value of Credit Suisse's mortgage assets and collateralized debt obligations (CDOs). Plaintiffs further claimed that defendants deliberately ignored weaknesses in Credit Suisse's risk management and internal controls for mortgage-related products.

The complaint was brought on behalf of two different sets of plaintiffs. The first group represented investors (both domestic and foreign) who purchased American depository receipts (ADRs) of Credit Suisse on the New York Stock Exchange (NYSE). The other group was comprised of foreign-cubed plaintiffs—foreign investors who purchased shares of Credit Suisse on the Swiss Stock Exchange.

On Oct. 5, 2009, the district court issued its initial decision regarding whether it had subject matter jurisdiction over this action.¹⁰ As in *Vivendi*, the court employed the conduct test. According to the court, foreign plaintiffs' jurisdictional argument relied primarily on the fact that Credit Suisse's investment banking segment is headquartered in New York and that certain investment banking and risk management officers live and work in New York.¹¹ However, the court found that such U.S.-based management was not enough to satisfy the conduct test to warrant the exercise of subject matter jurisdiction. The key issue for the court was that most of the alleged misrepresentations and omissions constituting the core of the fraud originated abroad. On that basis, foreign-cubed investors (unlike in *Vivendi*) were excluded from the class.

With regard to foreign investors who purchased ADRs on the NYSE, the court concluded that it was unable to determine whether it had subject matter jurisdiction over these claims. Focusing on the effects test, the court specifically noted that it did not have enough information about the residence of the proposed lead plaintiffs or about the percentage of Credit Suisse shares owned by U.S. investors compared to foreign investors during the class period. The court thus allowed plaintiffs' counsel to seek leave from the court to replead its complaint with more particularized jurisdictional allegations.¹²

After plaintiffs sought leave and submitted a new proposed complaint, the court issued another decision analyzing plaintiffs' new jurisdictional allegations. As to the amendments to the claims brought on behalf of foreign-cubed plaintiffs, the court noted that there was no change in the substance of the allegations regarding the content and location of the fraud. Because the "geographic source" of the alleged misstatements remained the same, the court found no grounds upon which to revise its prior finding that it could not exercise subject matter jurisdiction over the claims brought by foreign plaintiffs under the conduct test.¹³

With regard to the investors who purchased ADRs on the NYSE, the court noted that the proposed new complaint contained two additional allegations that "cure[d] the defects" identified by the court in its prior analysis.¹⁴ First, the named lead plaintiffs were identified as U.S. residents. Second, the proposed complaint noted that approximately 75 million shares of Credit Suisse securities, representing approximately 11.4 percent of the company's outstanding shares, were held by U.S. institutional investors. In light of these amendments, the court found that only domestic

investors who purchased ADRs on the NYSE can proceed with their claims in the United States since they satisfied the "effects" test.

'Fortis' Class Action

The allegations underlying the *Credit Suisse* and *Fortis* securities class actions were similar. Plaintiffs alleged that defendants concealed and misrepresented information about Fortis's CDOs and the extent to which its assets were held as risky subprime mortgage-backed securities. Plaintiffs also alleged that defendants had misled investors as to the extent to which Fortis' decision to acquire ABN AMRO Holding NV (ABN AMRO) had compromised the company's financial position. After Fortis was allegedly "bailed out" by the governments of Belgium, the Netherlands, and Luxembourg, investors brought a securities class action against Fortis and certain of its senior officers.

Defendants moved to dismiss the securities class action on subject matter jurisdiction grounds. On Feb. 18, 2010 (a week after the ruling in *Credit Suisse* had been issued), the court again employed the Second Circuit's conduct and effects test to analyze the factual allegations. First, as to the alleged conduct, the court concluded that the alleged fraud was "masterminded" in Brussels, not in the United States. In support of that conclusion, the court found that "[a]lthough all of the CDO valuation activity was performed by employees in New York City, the complaint alleges that all decisions on how to value the CDOs and how the company would report the values to the public were made in Brussels."¹⁵

According to the court, the complaint demonstrated that the New York office provided "complete" information to Fortis' headquarters in Brussels, "but the executives in Brussels deliberately disregarded that information in favor of minimizing the company's sub-prime exposure."¹⁶ Interestingly, the court rejected plaintiffs' argument that subject matter jurisdiction could be premised on Fortis' filings with the SEC relating to the terms of its acquisition of ABN AMRO securities. The court stated that "the act of filing documents with the SEC is insufficient standing alone to confer jurisdiction in an action for damages."¹⁷

As to the effects test, the court concluded that plaintiffs had not met their burden of adequately alleging substantial "effects" in the United States. The court acknowledged that there was "no doubt that some Fortis investors are U.S. residents, and that Fortis' alleged fraud had some effect upon U.S. investors and the U.S. securities market."¹⁸ However, based on the allegations in the complaint, the court could not determine whether the effect was "substantial."

In support of its holding, the court relied on the complaint's lack of detail regarding the number or percentage of U.S. resident investors, where U.S. investors may have purchased their securities, or any relationship that foreign purchasers had to the United States such that U.S. investors were actually affected by the harm that the foreign purchasers suffered.¹⁹ The court therefore dismissed the entire complaint for lack of subject matter jurisdiction.

Conclusion

The *Vivendi*, *Credit Suisse*, and *Fortis* actions illustrate the jurisdictional complexities presented by foreign-cubed securities class actions as well as the wide range of possible outcomes based on the court's analysis of the underlying facts. This week, the U.S. Supreme Court heard argument on the extraterritorial application of the U.S. securities laws in another foreign-cubed case, *Morrison v. National Australia Bank*.²⁰

The Supreme Court's decision in *National Australia Bank* may determine the scope of the extraterritorial application of the U.S. securities laws and provide more precise guidance on when foreign investors (like those included in the *Vivendi* class but excluded in the *Credit Suisse* and *Fortis* classes) and purchasers of ADRs in the United States (like those generally included in *Vivendi* and *Credit Suisse* but excluded in *Fortis*) should be permitted to pursue U.S. securities law claims in the United States. Indeed, the Supreme Court's ruling could lead to further jurisdictional analysis by the district court in the *Vivendi*, *Credit Suisse*, and *Fortis* cases.

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1. *In re Vivendi Universal S.A. Sec. Litig.*, No. 02-CV-5571 (SDNY Jan. 29, 2010).

2. *Cornwell v. Credit Suisse Group*, No. 08-CV-3758, 2010 WL 537593 (SDNY Feb. 11, 2010).

3. *Copeland v. Fortis*, No. 08-CV-9060 (SDNY Feb. 18, 2010).

4. *S.E.C. v. Berger*, 322 F.3d 187, 192 (2d Cir. 2003) (citations omitted); see *Morrison v. Nat. Australia Bank Ltd.*, 547 F.3d 167, 171 (2d Cir. 2008).

5. *Morrison*, 547 F.3d at 171.

6. *Berger*, 322 F.3d at 193 (citations omitted) (emphasis added).

7. *In re Vivendi Universal, S.A. Sec. Litig.*, 242 F.R.D. 76, 81 (SDNY 2007).

8. See *id.* at 102 (finding subject matter jurisdiction over the claims of French investors); 102-03 (finding subject matter jurisdiction over the claims of English investors); 105 (finding subject matter jurisdiction over the claims of Dutch investors).

9. *Id.* at 105.

10. *Cornwell v. Credit Suisse Group*, No. 08-CV-3758, 2009 WL 3241404 (SDNY Oct. 5, 2009).

11. *Id.* at 8.

12. *Id.* at 14.

13. *Cornwell v. Credit Suisse Group*, No. 08-CV-3758, 2010 WL 537593, 3 (SDNY Feb. 11, 2010).

14. *Id.*

15. *Copeland v. Fortis*, No. 08-CV-9060, 2010 WL 569865, 4 (SDNY Feb. 18, 2010).

16. *Id.* at 6.

17. *Id.* at 7.

18. *Id.* at 8.

19. The court also noted that Fortis' ADRs were traded on the over-the-counter market and thus "were traded in a less formal market with lower exposure to U.S. resident buyers." *Id.* at 8.

20. *Morrison v. Nat. Australia Bank Ltd.*, 547 F.3d 167 (2d Cir. 2008), cert. granted, 78 USLW 3309, 78 USLW 3319 (U.S. Nov. 30, 2009) (No. 08-1191).