International Practice Group

CROSS-BORDER SECURITIES AND DEBT LITIGATION

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CROSS-BORDER SECURITIES AND DEBT LITIGATION

- Where to litigate? Thinking outside the borders.

Jennifer Scullion, Senior Counsel

Where you choose to sue may make all the difference:

- — Choice of law
- — Comity
- — Substantive rights
- — Remedies
- — Procedural rights (discovery, ex parte proceedings, jury trial, appeals)
- — Compulsory process
- — Convenience
- — Speed
- — Secondary effects

- Within the U.S., choosing between the state and federal systems also raises many of the same issues.

Arbitration may also be an option to consider:

- Bilateral Investment Treaties ("BITs")
  - — More than 800 BITs have been concluded since 1987.
  - — Provide some basic requirements of equal and fair treatment of nationals and non-nationals.
  - — Provide a forum for resolution of investment-related disputes where the dispute relates to government interference with investment.
- Convention on the Settlement of Investment Disputes between States and Nationals of Other States ("ICSID"): the principal forum for BIT arbitrations.
  - — Specialized body.
  - — Growing body of case law.

Avenues to U.S. jurisdiction (if desired):

- Forum Selection Clauses:
  - — Mandatory v. permissive v. permissive w/ waiver of *forum non (AAR Int'l.*, 250 F.3d 510 (7th Cir. 2001))
  - — Exclusive v. optional
  - — Binding non-signatories sufficiently related to the agreement.
- U.S. securities law violations:
  - — Fraud
  - — Registration issues (affecting value and transferability of security)
  - — Trust Indenture Act ("TIA")
- Foreign Sovereign Immunities Act ("FSIA"), 28 U.S.C. §§ 1605-1607 (*Verlinden v. Central Bank of Nigeria*, 461 U.S. 480, 489-91 (1983)).

Parallel proceedings:

- U.S. federal approach = comity
  - — Both proceed until there is a judgment in one.
  - — Then examine whether to grant comity to any non-U.S. order or judgment.
  - — A foreign proceeding must "comport with American notions of fairness and due process." *In re Hourani*, 180 B.R. 58 (Bankr. S.D.N.Y. 1995).
  - — *In re: Brd. of Dirs. of Multicanal*
  - — Anti-suit injunctions.
- New York approach: race to courthouse

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CROSS-BORDER SECURITIES AND DEBT LITIGATION

- Who pays? Strategies beyond suing the issuer or debtor.

Louis M. Solomon, Partner

Cross-border litigation is a reality in today's global climate

- It reflects the global explosion of financial markets and multinational corporations and…
- A growing cast of U.S. and foreign investors willing to sue over securities and debt collection issues.
- Covered extensively in the Proskauer e-book, *Proskauer on International Litigation and Arbitration: Managing, Resolving, and Avoiding Cross-Border Business and Regulatory Disputes*, on line at www.proskauerguide.com.

How has the legal landscape changed?

- As of early October 2007, 16 securities lawsuits have been filed against foreign businesses – a 23% increase in the number of suits filed in all of 2006. (Source: USA Today, 10/23/07, "Securities Fraud Suits Go Global" by Edward Iwata)
- These numbers will only expand and accelerate over the next 5 to 10 years and beyond.
- Similar for cross-border debt collection cases.

The first hurdle – who can you sue?

Possible defendants beyond the issuer/debtor:

- —Directors & Officers
- —Corporate Agents
- —Successor Entities
- —Parents/Subsidiaries

The Usual Suspects: Directors & Officers

- Corporate directors and officers are liable for fraudulent acts and therefore are routinely named as defendants in securities cases.
- Liability attaches even if the fraudulent act was conducted in furtherance of corporate business.
- It is also immaterial that the director or officer received no personal benefits from the transaction.

Accountants & Attorneys Beware: Extending Liability to Agents In the Securities Arena

- While securities litigations have traditionally focused on the issuing company and its directors and officers, the legal landscape is changing.

- The demise of Enron saw a significant development in litigation strategy – the routine inclusion of accountants and transactional attorneys as defendants.

Primary v. Secondary Liability for Agents

- In 1994, the Supreme Court ruled in *Central Bank v. First Interstate Bank*, 511 U.S. 164, that plaintiffs cannot sue companies or individuals who only aid and abet a fraud.
- The Court stated in its opinion that:
  - "As in earlier cases considering conduct prohibited by § 10(b), we again conclude that the statute prohibits only the making of a material misstatement (or omission) or the commission of a manipulative act. . . . The proscription does not include giving aid to a person who commits a manipulative or deceptive act." 511 U.S. at 177.
  - "The absence of § 10(b) aiding and abetting liability does not mean that secondary actors in the securities markets are always free from liability under the securities Acts. Any person or entity, including a lawyer, accountant, or bank, who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies may be liable as a primary violator under 10b-5, assuming *all* of the requirements for primary liability under Rule 10b-5 are met." 511 U.S. at 191.
- Shortly after the Court's ruling, Congress gave the SEC and the DOJ the authority to pursue those who aid and abet a securities fraud, but still did not give investors a private right of action for this secondary form of liability.

Testing the Boundaries: The *Stoneridge* Case

- Since *Central Bank*, many cases have tested the boundaries of the Court's pronouncement that accountants, lawyers and banks can be found liable as primary violators.
- Currently before the Supreme Court is *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., et al.* - one of the most closely watched business cases in years.

Stoneridge At A Glance – The Facts

- At issue are a series of transactions between Charter Communications, a nationwide cable television provider, and Scientific-Atlanta and Motorola, producers of consumer used television cable boxes.
- Charter allegedly entered into a series of "sham" transactions with its vendors Scientific-Atlanta and Motorola to create the appearance of additional revenues when in fact the company's year-end cash flow would fall short of analysts' projection.
- The deal: Charter offered to pay Scientific-Atlanta and Motorola $20 *more* for each of hundreds of thousands of cable boxes they had already agreed to buy. Scientific-Atlanta and Motorola would then return the excess payments by buying large chunks of advertising from Charter, at rates far above those Charter normally charged advertisers.
- To create the impression the transactions were unrelated, Charter and the vendors backdated the contract increasing the price of the cable boxes.

Stoneridge At A Glance – The Procedure

- The Eastern District of Missouri dismissed the Complaint under *Central Bank* and the 8th Circuit affirmed the dismissal holding that a secondary actor, such as a vendor, accountant or attorney, is a primary violator only if it makes a fraudulent misstatement or omission or personally engages in manipulative securities trading practices.
- The Supreme Court granted *certiorari* on March 26, 2007. The question presented is:
  - "Whether this Court's decision in *Central Bank, N.A. v. First Interstate Bank, N.A.*, 511 U.S. 164 (1994), forecloses claims for deceptive conduct under § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5(a) and (c), 17 C.F.R. 240.l0b-5(a) and (c), where Respondents engaged in transactions with a public corporation with no legitimate business or economic purpose except to inflate artificially the public corporation's financial statements, but where Respondents themselves made no public statements concerning those transactions."

Where are we today?

- Oral argument held on October 9, 2007.
- Commentators speculate that the Justices gave every indication that they would uphold the dismissal against the vendors.
- The real significance of the Supreme Court's opinion will lie in the nuanced discussion surrounding the determination of who can and cannot be sued as a primary violator.

The Successorship Theory

Any entity which has succeeded to the assets, liabilities and/or business enterprise of the issuer/debtor may be equally liable for any and all fraudulent acts or contractual breaches undertaken by the issuer/debtor.

Case Highlight:
Aguas Lenders Recovery Group, LLC v. Suez, S.A., et al.
S.D.N.Y. Docket No. 06-CV-7873 (RLC)

- On behalf of ALRG, we filed suit over a year ago to recover, among other things, more than $135 million in principal and accrued interest due and owing on loans taken, nominally, by an entity known as Aguas Argentinas, S.A. ("Aguas").
- Aguas was a mere shell that was dominated, controlled, and fiscally abused by its majority shareholders, Defendants Suez and AGBAR
- With Aguas approaching insolvency, Suez/AGBAR manipulated Aguas's financing so that the interests of Suez/AGBAR – equity holders – purportedly took a priority position over the interests of Aguas's creditors.
- Aguas' most valuable asset – a Concession to operate the Buenos Aires water and sewer system – was transferred from the Aguas shell entity to a "new" entity, Agua y Saneamientos Argentinos Sociedad Anonima ("AySA"), which continued Aguas's business intact.
- We sued AySA, an Argentine corporation, under a theory of successor liability.

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Facts Evidencing Successorship:

- AySA holds itself out as the successor enterprise to Aguas to provide water and sewer services to the City of Buenos Aires.
- AySA took over all or substantially all of Aguas's assets, including Aguas's unbilled accounts receivable, offices, facilities, trucks, furniture, computers, files, etc.
- AySA has continued to provide water and sewer services to the same customer accounts as did Aguas.
- AySA assumed Aguas's contracts with vendors for goods and services.

Case Highlight:
Aguas Lenders Recovery Group, LLC v. Suez, S.A., et al.
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Facts Evidencing Successorship, continued:

- AySA retained all of the water production and sewage treatment facilities of Aguas with respect to the water and sewer system of Buenos Aires.

- AySA uses the new facilities and water lines that Aguas had built, improved or acquired in partial fulfillment of the Concession using monies borrowed by Aguas.

- AySA retained all the employees and nearly all of the management of Aguas and Aguas employees continued to work under the same agreement.

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Current Status of Litigation:

- ALRG settled its claims against Suez and AGBAR and is currently proceeding against AySA as successor to Aguas.
- AySA has moved to dismiss on various grounds, including lack of jurisdiction and forum *non conveniens.*
- The motion to dismiss has been fully briefed and is pending before the Honorable Robert L. Carter.

The Parent/Subsidiary Relationship

- As a general rule, a foreign corporation is not subject to jurisdiction based on the fraudulent or otherwise improper activities of a domestic subsidiary. Even so, a foreign based parent may be subject to jurisdiction on either an alter-ego or agency analysis. *See Doe v. Unocal,* 248 F.3d 915 (9th Cir. 2001).

- Alter-ego analysis generally involves showing that the foreign parent dominates the domestic subsidiary to such a degree that the two entities have no separate identity. *See id.* at 926-27.

- The agency test may be satisfied where the subsidiary performs functions that are "sufficiently important to the foreign corporation that if it did not have a representative to perform them, the corporation's own officials would undertake to perform substantially similar services." *Id.* at 928.

Potential Threshold Defenses

- Personal Jurisdiction
- Forum Selection
- Forum *Non Conveniens*
- Choice of Law

Overcoming Jurisdictional Issues

- As a general matter, an individual or entity will be subject to U.S. jurisdiction if the party has sufficient "contacts" with the U.S.
- Examples of possible sufficient "contacts" for securities fraud claims:
  - The entity lists its shares on a U.S. market.
  - The party makes frequent trips to the U.S. to work on company business or to negotiate the particular transaction at issue.
  - The party signed an SEC filing that is alleged to be false.
  - Email correspondence exists concerning or relating to the alleged fraudulent activities. *See Blumenthal v. Drudge*, 992 F. Supp. 44 (D.D.C. 1998).

Whose Law Applies

Critical Issues in the Choice of Law Analysis

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Whose Law Applies?
Today's Discussion

- Basic choice of law principles
- Application of choice of law principles in securities/debt litigation
- Extraterritorial application of U.S. law

Basic Choice of Law Principles

- Some of the leading choice of law rules:
  - "Center of gravity"/"significant relationship" test
  - Governmental interest analysis
- Which jurisdiction's choice of law rules apply?
  - In diversity actions, the choice of law rules of the forum determine what substantive law will govern the issues

"Depeçage"

- Choice of law analysis is issue by issue
  - "The courts have long recognized that they are not bound to decide all issues under the local law of a single state…Each issue is to receive separate consideration if it is one which would be resolved differently under the local law rule of two or more of the potentially interested states" (Restatement (Second) Conflicts of Law, §§ 145 & 188, cmts. d)
- The substantive laws of varying jurisdictions may apply in a single case to determine each of:
  - Breach of loan agreement
  - Successor liability
  - Doctrine of piercing corporate veil
  - Doctrine of sovereign immunity
  - What assets can be reached
  - Damages

Contractual Choice of Law Clauses

- Choice of law clauses are essential to international commercial transactions given the otherwise inevitable uncertainties that will arise over the applicable law for any disputes
- Enforceability of choice of law clauses
  - Party autonomy respected
  - Foreign law chosen by parties is presumptively valid *where underlying transaction is fundamentally international* notwithstanding U.S. securities laws anti-waiver provisions *Roby v. Corp. of Lloyd's*, 996 F.2d 1353 (2d Cir. 1993)
- Scope of choice of law clauses
  - "Governed by"/"construed in accordance with": apply to disputes concerning contract
  - "Arising out of"/"connected to": apply to contract and tort/ securities fraud

Absent a Choice of Law Clause

- Absent an effective choice of law clause, the choice of law rules of the forum are applied with often unpredictable outcomes
  - For contractual disputes over loan agreement: location of various "contacts" & weighing of purposes of laws/paramount interests of states
  - For securities fraud: locus of injury / place where misrepresentations occurred / place where acts in reliance occurred & weighing interests of states
  - For rights in/transfers of securities: U.C.C. Revised Art. 8

Extraterritorial Application of U.S. Securities Laws

- "The "conduct test": U.S. law applies extraterritorially where a material part of the fraud was perpetrated in the U.S.: the question is the degree of conduct required:
  - Second Circuit: Substantial acts in furtherance of the fraud committed within the U.S that (a) was more than mere preparatory conduct to the fraud and (b) directly caused the non-U.S. claimant's loss. *Psimenos v. E.F. Hutton & Co., Inc.*, 722 F.2d 1041, 1045 (2d Cir. 1983)
  - Other standards: requiring all factors that establish a securities fraud claim to have occurred in the U.S.; applying U.S. law when some activity to further fraudulent scheme occurred in U.S.
- The "effects test": U.S. law applies when the acts done outside the U.S. are intended to produce and produce detrimental effects within the U.S. *Schoenbaum v. Firstbrook*, 405 F.2d 200, 206 (2d Cir. 1968)
  - (see www.proskauerguide.com)

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Where are you likely to see, or need, Chapter 15?

- As a creditor
- As a defendant
- To effectuate a settlement
- To bind creditors

Chapter 15 and Recognition

- What is Chapter 15
- Commencement of a Chapter 15 Case
- Recognition as a Foreign Main Proceeding
- Recognition as a Foreign Non-Main Proceeding
- Denial of Recognition

Other Provisions of Chapter 15

- Additional Creditor Protections and the concept of being "sufficiently protected"
- Public Policy Exception to Recognition
- Commencement of Avoidance Actions
- The Chapter 15 Discharge

The Intersection of International Insolvency and U.S. Securities Law

- Recapitalization and the Issuance of New Securities
- Registration Requirements for New Issuance
- Exemptions in General
- Bankruptcy Exemption – Section 1145 of the Bankruptcy Code

Is there a Securities Law Exemption under Chapter 15?

- Unlike Chapter 11 - No independent exemption in Chapter 15
- Can Section 1145 be used in Chapter 15?
- Other exemptions potentially available to a Foreign Debtor in connection with a Chapter 15