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CORPORATE AND SECURITIES LITIGATION

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Extraterritorial Application of U.S. Securities Laws

Because the Securities Exchange Act of 1934 is silent as to its extraterritorial application, federal courts have been left to interpret its reach, using analyses based upon congressional policy.

Since the intent of the 1934 Act is to protect American investors and American markets, the issue of whether that statute should be applied to foreign investors who purchased securities on foreign exchanges, might appear to be straightforward. However, increasing transnational businesses and an increasing number of transnational securities fraud cases have brought application of the U.S. securities laws to foreign persons, corporations, and transactions to the fore of federal securities law issues.

'In re AstraZeneca Securities'

The most recent decision in this circuit with respect to the extraterritorial application of the 1934 Act is Southern District Senior Judge Thomas Griesa's June 3, 2008 decision in *In re AstraZeneca Securities Litigation*.[1] *AstraZeneca* was a putative class action suit brought against a U.K. company with its U.S. headquarters in Delaware, and four of its officers and directors. AstraZeneca's stock traded on the London, Stockholm, and New York Stock Exchanges. Over 90 percent of the members of the putative class were foreigners who purchased their shares on foreign exchanges. The amended complaint alleged fraudulent misrepresentations and omissions in press releases, during investor conference calls, and in AstraZeneca's Annual Report and Annual Business Review regarding the risks, safety and efficacy of a drug then in late-stage clinical trials. The plaintiffs claimed that these misrepresentations and omissions artificially inflated AstraZeneca's stock price, resulting in losses when the FDA failed to recommend the drug for approval and the company's stock price declined.

The defendants moved to dismiss the amended complaint pursuant to Rules 12(b)(1), 12(b)(6) and 9(b) of the Federal Rules of Civil Procedure, as well as the Private Securities Litigation Reform Act. Among other things, the defendants argued that the district court did not have subject matter jurisdiction over the claims of foreign purchasers who acquired AstraZeneca's stock on foreign exchanges. The court dismissed the case in its entirety, finding that (1) plaintiffs had not adequately alleged subject matter jurisdiction over the claims of foreigners who purchased on foreign exchanges and (2) plaintiffs had failed to allege scienter adequately against any of the defendants.

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On the issue of subject matter jurisdiction, the court identified the two tests used in transnational securities fraud cases: the "conduct test" and the "effects test," satisfaction of either of which is sufficient to establish jurisdiction. The "effects test" analyzes whether conduct occurring outside the United States has had a substantial adverse effect on U.S. investors or the U.S. securities market. See *Schoenbaum v. Firstbrook*, 405 F.2d 200, 206-09 (2d Cir. 1969). The "conduct test," upon which the *AstraZeneca* decision was based, considers whether conduct that occurred within the United States is alleged to have played some part in the perpetration of a securities fraud on foreign investors. See *Itoba Ltd. v. LEP Group PLC*, 54 F.3d 118, 122 (2d Cir. 1995). To satisfy the conduct test, and thereby confer jurisdiction over the claims of foreign investors who purchased on foreign exchanges, the conduct in the United States must have been a significant part of the fraud—not merely preparatory to the fraud—and (at least in the U.S. Court of Appeals for the Second Circuit) the acts (or failures to act), in the United States must have "directly caused" the foreign plaintiffs' losses. *Bersch v. Drexel Firestone Inc.*, 519 F.2d 974, 994 (2d Cir. 1975).

Judge Griesa reviewed the allegations of U.S. conduct in *AstraZeneca* and found them sufficient to support jurisdiction. No bright-line test exists for the quantum or type of conduct required, leaving courts to determine on a case-by-case basis whether exercising jurisdiction is consistent with U.S. policy interests. Those interests include not allowing fraudsters to use the United States as a base to defraud foreigners, insuring high standards of conduct in the securities markets, and the allocation of judicial resources. See, e.g., *SEC v. Kasser*, 548 F.2d 109, 114, 116 (3d Cir. 1977). Where substantial conduct alleged to constitute the fraud occurs in the United States, then the decision is an easy one. Id. at 111-12. Where a relatively "insubstantial" part of the fraudulent conduct occurs in the United States, there too the decision is an easy one. See, e.g., *Europe & Overseas Commodity Traders, S.A. v. Banque Paribas London*, 147 F.3d 118, 129 (2d Cir. 1998) (no jurisdiction where the only U.S. conduct is a series of phone calls to a transient foreign national in the United States). However, where the alleged fraudulent conduct occurs both within the United States and elsewhere, as is most often true in multinational cases, the factual analysis becomes crucial.

The Second Circuit

And yet, there is very little guidance from the Second Circuit on the issue.

> [T]he Second Circuit has instructed that whether the alleged misrepresentations were actually made in the United States, or in another country, or whether a material domestic act directly caused the alleged harm is not in and of itself determinative. Nor is the site of the preparation of registration statements filed in this country by itself a sufficient jurisdictional consideration…[i]n fact the Circuit Court has cautioned against mechanical reliance in any particular factor as a sufficient decisional guide from one case to another. *In re Alstom SA Sec. Litig.*, 406 F. Supp. 2d 346, 374-75 (S.D.N.Y. 2005) (internal citations omitted).

In finding the U.S. conduct in *AstraZeneca* to be sufficient to confer subject matter jurisdiction, Judge Griesa cited the allegations that: "numerous misleading press releases

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were produced at AstraZeneca's headquarters in Delaware; the Annual Business Review, at which several alleged misrepresentations occurred, took place in Delaware; results of trials were announced at medical conferences in the United States; a misleading Annual Report was filed with the SEC; several meetings with analysts and investors were conducted in the United States throughout the class period" as were communications between the defendants and the FDA. The court concluded that these alleged U.S. activities were "more than merely preparatory to the fraud," and thus met the first prong of the conduct test. 2008 WL 2332325, at *11.

Moving to the second prong of the conduct test, Judge Griesa concluded that subject matter jurisdiction did not exist over the foreign purchasers on foreign exchanges because plaintiffs had not alleged facts sufficient to demonstrate that the domestic-based conduct directly caused the plaintiffs' losses. 2008 WL 2332325 at *11. Unlike other circuit courts, which appear to require only that domestic conduct be significant to the fraud,[2] the Second Circuit requires that such conduct directly cause the plaintiffs' injury. *Bersch,* 519 F.2d at 994.

The Reliance Requirement

As an initial matter, Judge Griesa looked at whether the foreign plaintiffs relied upon the U.S. conduct, since fraudulent conduct was alleged to have occurred both in the United States and abroad. To satisfy the reliance requirement, the plaintiffs attempted to persuade the court to accept a global "fraud-on-the-market" presumption, as is available to American purchasers. *Basic Inc. v. Levinson,* 485 U.S. 224, 241 (1988). Thus, the plaintiffs did not allege reliance on any particular U.S. conduct, but rather reliance on the global market price.

The court did not disagree that the fraud-on-the-market theory holds true both within and outside the United States. In fact, Judge Griesa acknowledged that AstraZeneca's stock price moved on foreign markets in alignment with the U.S. stock price throughout the class period. Noting that the Second Circuit has not addressed this issue, the court declined to apply a global fraud-on-the-market presumption to the foreign plaintiffs' claims in the absence of clear authority from the Second Circuit.

Judge Griesa cited decisions from several other courts which had similarly declined to apply the presumption, not because the markets did not move globally, but because "allowing foreign purchasers on foreign exchanges to plead reliance in this manner would extend the jurisdictional reach of the U.S. securities laws too far." 2008 WL 2332325 at *12, (citing *In re Baan Co. Sec. Litig.,* 103 F. Supp. 2d 1, 10 (D.D.C. 2000); *Tri-Star Farms Ltd. v. Marconi, PLC*, 225 F.Supp.2d 567, 578-79.) Other district courts have allowed similar claims brought by foreign purchasers to proceed without specific analysis of reliance or a global fraud-on-the-market. See, e.g., *In re Gaming Lottery Sec. Litig.,* 58 F.Supp.2d 62 (S.D.N.Y. 1999) (finding that the defendants' misstatements and omissions caused damage to the foreign plaintiffs by artificially inflating the stock price on both NASDAQ and the foreign exchange).

If the Second Circuit ultimately rejects a global fraud-on-the-market presumption (as it undoubtedly will do) and requires foreign plaintiffs (trading on foreign exchanges) to allege actual reliance on U.S. fraudulent activities for subject matter jurisdiction, then in the future such plaintiffs are likely to be limited to individual plaintiffs or small groups of similarly situated plaintiffs in a position to make such a demonstration.[3]

Since Judge Griesa rejected subject matter jurisdiction on the basis of the foreign plaintiffs' failure to plead reliance, it was unnecessary for the court to determine whether the alleged misstatements directly caused the plaintiffs' losses, a difficult issue in other cases. Although the Second Circuit has instructed that it is the substantial domestic fraudulent conduct that must cause the foreign plaintiffs' losses, what conduct is required or whether it caused the loss is not always evident.

For example, if all the alleged misstatements occurred outside the United States, but the actions that formed the basis for the misstatements occurred within the United States, such as allegedly fraudulent activities occurring at a subsidiary then consolidated into a foreign companies financials or public statements, is subject matter jurisdiction over claims by foreign purchasers on foreign exchanges established?

Different district courts within the Second Circuit have answered the question differently. In *Alstom* and *Gaming Lottery,* the district courts answered this question in the affirmative, whereas in *Froese v. Staff,* 2003 WL 21523979 (S.D.N.Y. July 7, 2003), *In re Bayer AG Sec. Litig.,* 423 F.Supp.2d 105 (S.D.N.Y. 2005), and *In re National Australia Bank Sec. Litig.,* 2006 WL 3844465 (S.D.N.Y. Oct. 25, 2006), the courts declined jurisdiction, finding that the U.S. conduct did not itself constitute securities fraud and that misstatements made abroad about that conduct were the direct cause of the financial losses.

The Future

Determining U.S. subject matter jurisdiction over complex transnational securities fraud cases will always need to be governed by flexible and fact-specific analyses. However, for purposes of greater judicial uniformity as well as a greater degree of certainty in the international business community about the parameters of U.S. jurisdiction, the district courts should have better guidance than deciding cases "on very fine distinctions" with the ultimate decision based upon a court's "impression" of whether subject matter jurisdiction exists. *In re National Australia Bank,* 2006 WL 3844465, at *4, *8. In U.S. District Judge Victor Marrero's extensive opinion on subject matter jurisdiction in the *Alstom* case, he notes the elusive quest for a cohesive doctrine and sets forth six common and essential threads "stitched together from the jurisprudence," which are used in this circuit to determine jurisdiction.

The last "thread" sums up the present latitude accorded the district courts by the Second Circuit: "an overarching measure of reasonableness gauged by the intent of congressional policy and principles of fairness on the circumstances surrounding the particular case." 406 F.Supp.2d at 376. See *Banque Paribas,* supra (U.S. conduct sufficient but "surrounding circumstances" did not justify exercise of jurisdiction).

The Southern District appears poised to grapple with this issue again in the class-action suit against the French bank Société Générale (SocGen). *In re Societe Generale Sec. Litig.,* Index No. 08-cv-02495 (GEL). Recent news reports indicate that the class action lawyers are soliciting French plaintiffs who purchased SocGen stock on foreign exchanges. The action was originally brought on behalf of U.S. purchasers but plaintiffs apparently will seek to amend the complaint in September to add foreign purchasers on foreign exchanges. Perhaps, in one of the increasing number of transnational cases, the Second Circuit will be given the opportunity to provide additional guidance on these increasing and difficult subject matter jurisdiction issues.

1. *In re AstraZeneca Sec. Litig.,* 2008 WL 2332325 (S.D.N.Y. June 3, 2008).

2. The Third, Eighth and Ninth circuits appear to require only that the domestic conduct be significant to the fraud, rather than the direct cause of it. See *Robinson v. TCI/US W. Comm. Inc.,* 117 F.3d 900, 906 (5th Cir. 1997).

3. A related securities class action issue not covered in this article is the foreign enforceability of a U.S. judgment. See, e.g. *Borochoff v. Glaxosmith Kline PLC*, 246 F.R.D. 201 (S.D.N.Y. 2007).