2008 ALI-ABA SECURITIES LITIGATION PROGRAM

BOSTON, MA

LANGHAM HOTEL

MAY 1-2, 2008

CHALLENGES FACING FOREIGN INVESTORS IN U.S. SECURITIES CLASS ACTIONS

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INTRODUCTION

A growing trend has emerged with more and more international investors actively participating in securities class actions in the United States.[2] Institutional Shareholder Services, Inc. ("ISS"), a company that provides financial research and analysis, recently undertook a study of all international institutional investors seeking lead plaintiff status in U.S. securities class actions. According to the ISS study, international investors have sought lead plaintiff status in more than 5% of all newly-filed federal securities class actions since 2002. In fact, in 2005, international investors moved to serve as lead plaintiff in approximately 16% of all newly-filed actions and, in 2006, moved in 12% such actions.[3]

The increased willingness of international investors to actively participate in U.S. securities class actions is due, at least in part, to the fact that the U.S.-style class action

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[2] Wrighton, Jo, "THE BUY SIDE – See You in Court!," Institutional Investor (International Edition), June 2007 (noting that "a growing number of European money managers are embracing activism in the U.S." via class action lawsuits).

[3] Institutional Shareholder Services, "Accountability Goes Global: International Investors and US Securities Class Actions," 2007, http://www.issproxy.com/pdf/AccountabilityGoesGlobal.pdf at 1.

lawsuit exists nowhere else.[4] Benefits to filing in the United States, beyond the class action device, include the availability of contingency fee agreements, broad discovery rules, the absence of fee-shifting or loser-pay rules for attorney's fees, and the potential for a large jury verdict.[5] The financial risks of suing in their own home country deter many foreign investors who instead opt to sue in the United States.[6]

Foreign investors face the traditional hurdles in seeking lead plaintiff status, yet they face additional challenges such as dismissal or ultimately exclusion from the class due to their foreign status.[7] For instance, attacks such as *res judicata* and subject matter jurisdiction may be insurmountable to a foreign investor seeking redress in a U.S. securities class action.[8] A foreign investor may face such challenges at both the lead

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[4] Practising Law Institute, Corporate Law and Practice Course Handbook Series, "The Current Role of Foreign Investors in Federal Securities Class Actions," 1620 PLI/Corp 11, 15 September-October 2007 (noting that most countries outside the United States do not provide the class action device available in the United States under Fed. R. Civ. P. 23). *See also* Geier, Peter, "A Wary Europe Moves a Step Closer to Class Actions," The National Law Journal, 12/05/2006 (noting that even countries who have adopted some form of class action, such as England, Sweden, Spain, Germany and the Netherlands, still do not have "anything as broad and freewheeling as U.S.-style class action litigation").

[5] *Id. See also* Rysavy, Charles F. and Raghavan, Pranita A., "The (Often Insurmountable) Hurdles Facing Foreign Claimants Prosecuting Class Actions in American Courts," Tort Trial & Ins. Practice Law Journal, Fall 2006 (42:1) (noting that "[t]he combination of substantive and procedural advantages offered to plaintiffs in U.S. courts, unavailable in any other country, exerts a strong pull on foreign plaintiffs").

[6] *See, e.g.*, Wrighton, Jo, "THE BUY SIDE – See You in Court!," Institutional Investor (International Edition), June 2007 (according to the head of legal affairs at Metzler Asset Management, based in Frankfurt, "The financial risks stops us from going to court in Germany… We could lose everything").

[7] Geier, Peter, "A Wary Europe Moves a Step Closer to Class Actions," The National Law Journal, 12/05/2006 (stating that "American courts generally have not been receptive to American firms' efforts in trying to import European plaintiffs into U.S. lawsuits").

[8] Kemal-Brooke, Adam, "US Securities Class Actions – Them and US," Post Magazine, February 1, 2007 ("When the inherent difficulties with the notification procedure are combined with the absence of treaties between foreign jurisdictions and the US to enforce the judgments of its courts, it is unlikely that either a court judgment or a settlement agreement, which binds non-participants or non-signatories, would be enforceable in a European court"); Practising Law Institute, Corporate Law and Practice Course Handbook Series, "The Current Role of Foreign Investors in Federal Securities Class Actions," 1620 PLI/Corp at 17 (noting that subject matter jurisdiction may be a significant issue when foreign investors represent a class in the United States).

plaintiff and class certification stage, as well as on a motion to dismiss. This paper provides an over-view of the challenges a foreign investor may face in a U.S. securities class action.

I. Potential Hurdles Facing International Investors at the Lead Plaintiff Stage

In determining who to appoint as lead plaintiff in a securities class action, courts are guided by the Private Securities Litigation Reform Act of 1995 ("PSLRA"), 15 U.S.C. §78u-4. The PSLRA provides that the court shall adopt a presumption that the most adequate plaintiff is the person or group of persons that: (1) has either filed a complaint or made a motion seeking lead plaintiff status; (2) has the largest financial interest in the relief sought by the class; and (3) otherwise satisfies the typicality and adequacy requirements of Rule 23 of the Federal Rules of Civil Procedure.[9] This presumption may be rebutted "only upon proof by a member of the purported plaintiff class that the presumptively most adequate plaintiff (aa) will not fairly and adequately protect the interests of the class; or (bb) is subject to unique defenses that render such plaintiff incapable of adequately representing the class."[10]

A foreign investor that is found to be the presumptive lead plaintiff may nonetheless be subject to attack if a competing movant is able to show that the foreign investor is subject to a unique Rule 23(b)(3) superiority defense on subject matter jurisdiction or *res judicata* grounds.

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[9] 15 U.S.C. § 78u-4(a)(3)(B)(iii)(I).

[10] 15 U.S.C. § 78u-4(a)(3)(B)(iii)(II).

A. Subject Matter Jurisdiction At the Lead Plaintiff Stage

Although the Securities Exchange Act of 1934[11] is silent as to its extraterritorial application, federal courts have recognized that their subject matter jurisdiction, or authority to adjudicate a case, may extend to transnational securities fraud. *See, e.g.*, *S.E.C. v. Berger*, 322 F.3d 187, 192 (2d Cir. 2003) ("Although Title 15 of the United States Code, which sets forth the various statutes governing securities exchanges, is silent as to the extraterritorial application of these statutes, we have recognized that subject matter jurisdiction may extend to claims involving transnational securities frauds.").

Courts have developed two tests, the "effects" test and the "conduct" test, to determine whether they have subject matter jurisdiction over transnational securities claims involving foreign plaintiffs and/or defendants.[12] Under the effects test, the court analyzes the impact of the fraudulent activity occurring overseas on U.S. investors and on securities traded on U.S. securities exchanges.[13] Under the conduct test, the court considers whether conduct that occurred within the U.S. is alleged to have played some role in the perpetration of securities fraud on foreign investors.[14] The application of the

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[11] 15 U.S.C. § 78a, *et. seq.*

[12] Kemal-Brooke, Adam, "US Securities Class Actions – Them and US", Post Magazine, February 1, 2007 at 1 ("[t]he US courts do not require a company to be listed on a US exchange, or even to have a major business presence in the US, to find jurisdiction over the company and a dispute. To establish whether [subject matter] jurisdiction exists … the courts have developed two tests: the conduct test and the effects test").

[13] *See, e.g., In re Rhodia S.A. Sec. Litig.*, 05 Civ. 5389, 2007 WL 2826651 at *8 (S.D.N.Y. Sept. 26, 2007) (quoting *Europe & Overseas Commodity Traders, S.A. v. Banque Paribas*, 147 F.3d 118, 128 (2d Cir.1998)).

[14] *In re Royal Dutch/Shell Transp. Sec. Litig.*, 380 F. Supp. 2d 509, 540 (D.N.J. 2005).

conduct test is very-fact specific, and as such particular cases are decided on "very fine distinctions." [15]

Commentators have noted that the conduct test rather than the effects test is normally used when determining jurisdiction over foreign investors' securities claims against foreign defendants.[16] Accordingly, this article will focus on the application of the conduct test.[17]

1. Federal Circuit Split on How to Apply the Conduct Test

Federal Circuit courts are split in how they apply the conduct test. The Second,[18] Fifth and District of Columbia Circuits hold the more restrictive view that subject-matter jurisdiction over foreign acts of securities fraud only exists if the defendant's conduct

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[15] *In re National Austl. Bank Sec. Litig.*, No. 03 CIV 6537 (BSJ) 2006 WL 3844465, at *3-4 (S.D.N.Y. Oct. 25, 2006).

[16] Practising Law Institute, Corporate Law and Practice Course Handbook Series, "The Current Role of Foreign Investors in Federal Securities Class Actions," 1620 PLI/Corp 11, 33 September-October 2007.

[17] At least one court has exercised subject matter jurisdiction over the claims of a "foreign cubed" investor where the facts alleged satisfy the effects test, but not the conduct test. In *In re Parmalat Sec. Litig.*, 376 F. Supp. 2d 472 (S.D.N.Y. 2005), a class of U.S. and European plaintiffs survived motions to dismiss after the court found that it had subject matter jurisdiction over claims brought against Parmalat, an Italian company that traded only on overseas markets, and Parmalat's bank and financier. Both the bank and the financier had participated in transactions that created fictitious assets for Parmalat, while Parmalat had falsified its financial information knowing that investors in the U.S. would receive and rely upon that information. *Id.* at 511-512. The court noted that even though neither Parmalat nor its bank or financier had committed any "substantial acts" in the U.S., the effects of the defendants' overseas acts on U.S. investors were sufficient to sustain jurisdiction. *Id.* Nevertheless, as seen in the discussion of case law throughout this article, the majority of courts apply the conduct test in determining jurisdiction over the claims of foreign investors against foreign companies.

[18] There also are two important facets to Second Circuit case law on the conduct test. The Second Circuit has held that even non-fraudulent conduct within the U.S. may confer subject matter jurisdiction so long as that conduct substantially furthers the foreign fraudulent scheme. *Psimenos v. E.F. Hutton & Co.*, 722 F.2d 1041, 1044 (2d Cir. 1983) (where fraudulent transactions were completed via non-fraudulent trading contracts executed by defendant in the U.S., defendant's U.S. conduct was sufficient to confer subject matter jurisdiction). Also, the Second Circuit has noted that, even where the conduct test is fully met, an additional "tipping factor" in favor of jurisdiction may still be required if "the surrounding circumstances show that no relevant interest of the United States [is] implicated". *Europe & Overseas Commodity Traders*, 147 F.3d at 129 (holding that "a series of calls to a transient foreign national in the United States" was not enough to establish jurisdiction under the conduct test without some tipping factor). *See also In re Bayer AG Sec. Litig.*, 423 F. Supp. 2d 105, 113 (S.D.N.Y. 2005) (noting that the Second Circuit looks to "tipping factors" in determining whether the conduct test has been met).

within the U.S. was more than "merely preparatory" to securities fraud committed overseas – that is, that the defendant's conduct within the U.S. was a **direct** cause of the foreign investors' losses.[19]

The Third, Seventh, Eighth and Ninth Circuits apply a less-strict standard which generally requires a lesser standard of conduct than the "direct causation" test demanded by the Second, Fifth and District of Columbia Circuits.[20] So long as the relevant U.S. conduct is material or significant to the fraud, the court may assert subject matter jurisdiction.[21]

2. "Foreign Cubed" Investors As Lead Plaintiffs

Although courts more typically consider subject matter jurisdiction over foreign plaintiffs in the context of a motion to dismiss or at the class certification stage, some courts have considered this issue at the lead plaintiff stage. Generally, the only foreign

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[19] *See, e.g., Robinson v. TCI/US West Commc'ns Inc.*, 117 F.3d 900, 905-906 (5th Cir. 1997) ("The circuits are divided as to precisely what sort of activities are needed to satisfy the conduct test … the more restrictive position-that the domestic conduct must have been 'of material importance' to or have 'directly caused' the fraud complained of-is followed in the Second and District of Columbia Circuits .... [t]he Third, Eighth, and Ninth Circuits, in contrast, generally require some lesser quantum of conduct … we adopt the Second Circuit's test") (citation omitted). *See also, S.E.C. v. Berger*, 322 F.3d 187 at 193; *Zoelsch v. Arthur Andersen & Co.*, 824 F.2d 27, 31 (D.C. Cir. 1987).

[20] *In re Cable & Wireless, PLC*, 321 F. Supp. 2d 749, 758 (E.D. Va. 2004) ("The Third, Seventh, Eighth, and Ninth Circuits have all employed a more relaxed standard which generally requires some lesser degree of conduct than the 'direct causation' test used by the Second, Fifth, and District of Columbia Circuits.") (citation omitted). Also, although the Fourth Circuit has not yet recognized the conduct test, the District of Maryland and Eastern District of Virginia courts each have applied the version of the test endorsed by the Third, Seventh, Eighth and Ninth Circuits. *See In re Royal Ahold N.V. Sec. & ERISA Litig.*, 351 F. Supp. 2d 334, 360-361 (D. Md. 2004); *Cable & Wireless*, 321 F. Supp. 2d at 763.

[21] *Kauther SDN BHD v. Sternberg*, 149 F.3d 659, 666-67 (7th Cir.1998) ("[w]hen the conduct occurring in the United States is *material* to the successful completion of the alleged scheme, [subject matter] jurisdiction is asserted.") (citation omitted) (emphasis added); *Travis v. Anthes Imperial Ltd.*, 473 F.2d 515, 524 (8th Cir.1973) (" [Subject matter jurisdiction] attaches whenever there has been *significant* conduct with respect to the alleged violations in the United States. And this is true even though the securities are foreign ones that had not been purchased on an American exchange.") (emphasis added); *Grunenthal GmbH v. Hotz*, 712 F.2d 421, 425 (9th Cir.1983) (holding that the defendants' U.S.-based conduct was sufficient to establish subject matter jurisdiction where the conduct was "significant with respect to the alleged violation ... and… furthered the fraudulent scheme.") (citation omitted).

claimants who will encounter difficulties in seeking appointment as lead plaintiff based on subject matter jurisdiction are so-called "foreign-cubed" plaintiffs: foreign investors who purchased the securities of a foreign company trading on foreign exchanges.[22] Foreign-cubed plaintiffs are likely to encounter challenges to their adequacy as lead plaintiffs on grounds that they are subject to the unique defense of lack of subject matter jurisdiction over their claims. To withstand such challenges, foreign-cubed plaintiffs must show that the complaint alleges facts sufficient to meet the conduct test for subject matter jurisdiction.

For example, in *In Re Cable and Wireless, PLC Sec. Litig.*,[23] the plaintiffs brought securities fraud claims against a British company whose stock traded on both foreign and U.S. exchanges. The complaint allegations were that the defendants had engaged in a scheme to fraudulently inflate the value of the British company's securities, and that the defendants had undertaken substantial fraudulent activity within the U.S. in furtherance of the overseas fraudulent scheme. Among the applicants for lead plaintiff was a Canadian institutional investor that had purchased the corporate defendant's stock on the London Stock Exchange. The court appointed the Canadian institution as co-lead plaintiff, and specifically noted that it was likely to be able to meet the conduct test and successfully defend against a lack of subject matter jurisdiction argument given that the complaint alleged that a substantial portion of the fraud occurred in the U.S.[24]

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[22] Practising Law Institute, Corporate Law and Practice Course Handbook Series, "The Current Role of Foreign Investors in Federal Securities Class Actions," 1620 PLI/Corp 11, 23 September-October 2007 (federal court "opinions on lead plaintiff motions confirm that it is only the 'foreign cubed' situation that presents a challenge for the foreign investor.")

[23] 217 F.R.D. 372, 374 (E.D. Va. 2003).

[24] The court also appointed a U.S. individual investor who had purchased ADRs on the U.S. exchange, stating that the U.S. investor's claims would not be subject to jurisdictional defenses. *Id.* at 377.

In contrast, in *Royal Ahold* the court refused to appoint a German financial institution as lead plaintiff due in part to concerns that the German investor was subject to the unique defense of subject matter jurisdiction.[25] Much of the plaintiffs' case was based on allegedly fraudulent statements issued by Royal Ahold from the Netherlands. Moreover, the plaintiffs alleged that Royal Ahold had reported inflated results for certain joint ventures whose activity took place mostly outside the U.S.[26] In denying lead plaintiff status to the German fund, the *Royal Ahold* court stated that defendants' conduct within the U.S. was insufficient to serve as a basis for jurisdiction and that as such the German fund was unable to meet the conduct test and likely to face a serious subject matter jurisdiction attack.[27]

B. ***Res Judicata*** **at the Lead Plaintiff Stage**

Although courts initially appeared to reserve *res judicata* for the class certification stage, more courts are tackling this issue at the lead plaintiff stage. [28] The doctrine of *res judicata* is intended to bar parties from re-litigating the same case in a different venue after a valid final judgment has been rendered in the U.S. If a foreign

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[25] 219 F.R.D. 343, 351-353 (D. Md. 2003).

[26] *Id.* at 352.

[27] *Id.* at 352-353. *See also In Re Royal Dutch/Shell Transp. Sec. Litig.*, No. 04-374 (JWB), slip op. (D.N.J. June 30, 2004) (denying a Belgian investment advisor lead plaintiff status due to serious doubts as to the court's jurisdiction over the proposed foreign lead plaintiff's claims; applying the conduct test, the court determined that no material facts had occurred in the U.S. and the likely future battle over subject-matter jurisdiction would distract the Belgian advisor and prevent his serving as an adequate lead plaintiff).

[28] *Compare Takeda v. Turbodyne Techs., Inc.*, 67 F. Supp. 2d 1129, 1139 (C.D. Cal. 1999) (stating that "[c]oncerns respecting the res judicata impact of any judgment in favor of defendants, which have been the focus of decisional discussion of the difficulties inherent in certifying transnational classes, are not an issue with respect to the selection of Lead Plaintiffs, since those persons will clearly be bound by the judgment of the court") *with Borochoff v. Glaxosmithkline PLC*, 246 F.R.D. 201, 205 (S.D.N.Y. 2007) (the court, in finding that the presumptive lead plaintiff (a group comprised of German investors) had been rebutted, noted the possibility that a German court may not enforce a decision in favor of defendants against foreign plaintiffs in the class).

court would neither recognize nor enforce a U.S. judgment, then a concern exists that a foreign investor, unhappy with the outcome in the United States, could get a second bite at the apple by bringing suit in their home country. As such, a U.S. court may find such an investor inadequate to serve as lead plaintiff.

For instance, courts have denied lead plaintiff status to a foreign investor based on the mere possibility that a foreign court would not give *res judicata* effect to a U.S. judgment. In *Royal Ahold*,[29] the presumptive lead plaintiff was a group comprised of a German financial institution and a domestic pension plan. The main concern that the *Royal Ahold C*ourt had with the proposed lead plaintiff group was that the German investor was subject to the unique defense of both subject matter jurisdiction and *res judicata*.[30] The *Royal Ahold* Court stated that although no specific evidence had been produced regarding which foreign courts may or may not recognize a decision in the case; the possibility nonetheless existed that the German investors as well as other foreign purchasers might be eliminated from the class at the class certification stage.[31] The *Royal Ahold* Court found that the status of the presumptive lead plaintiff had been rebutted, particularly in light of "the possible absence of subject matter jurisdiction… and the possibility that foreign courts [would] not enforce a decision in favor of [defendants] against foreign plaintiffs in the class."[32]

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29 *In re Royal Ahold N.V. Sec. and ERISA Litig.*, 219 F.R.D. 343 (D. Md. 2003).

30 *Id.* at 351-352.

31 *Id.* at 352.

32 *In re Royal Ahold*, 219 F.R.D. at 353. *In re Discovery Laboratories Sec. Litig.*, No. 06-1820, p. 5 n. 2 (E.D. Pa. July 24, 2006) (stating that, even if court found foreign investor adequate to serve as lead plaintiff, the court would nonetheless deny its motion since foreign investor would be subject to attack based on *res judicata* and subject matter jurisdiction). *But see Mass. Laborers' Annuity Fund v. Encysive Pharms. Inc.*, No. H-06-3022, p. 10 (S.D. Tex. March 20, 2007) (appointing foreign entity lead plaintiff

Similarly, in *Borochoff v. Glaxosmithkline PLC,*[33] a group of German institutional investors (the "German Institutional Investor Group") sought appointment as lead plaintiff of the class. After determining that the German Institutional Investor Group suffered the largest financial interest in the relief sought by the class and was entitled to the presumption of being the most adequate plaintiff, the *Glaxosmithkline* Court nonetheless found that this presumption had been rebutted because a judgment in the action may be refused enforcement by a German court.[34] "If this Court's judgment on the merits neither protects a prevailing defendant against relitigation in Germany, nor grants a prevailing German plaintiff an enforceable damage judgment, then for those litigants a class action is not 'superior'…. Rather, it is a waste, and their presence in the class…may inflict burdens on the administration of the action."[35] The *Glaxosmithkline* Court further noted that a declaration submitted by a professor that "concede[d] that the binding effect of a U.S. class action judgment is disputed in German legal literature and undecided by German court[s]" failed to persuade the Court that the probabilities favored its acceptance.[36]

More recently, however, in *Mohanty v. Bigband Networks, Inc., et al,* Docket No. 07-cv-05101 (SBA), 2008 WL 426250 (N.D. Cal. Feb. 14, 2008), an individual plaintiff,

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despite possibility entity would not be bound by *res judicata* because movant affirmed to court that it would be bound); *In re Molson Coors Brewing Co. Sec. Litig.*, 233 F.R.D. 147, 153 (D. Del. 2005) (finding *res judicata* argument a "red herring" and "conjecture" and appointing foreign investor as lead plaintiff); *In re Goodyear Tire & Rubber Co. Sec. Litig.*, 03-CV-2166, 2004 WL 3314943 at *5 (N.D. Ohio May 12, 2004) ("to exclude a foreign investor from lead plaintiff status on nationality grounds would defy the realities and complexities of today's increasingly global economy").

[33] *Borochoff*, 246 F.R.D. at 201.

[34] *Id.* at 203-205.

[35] *Id.* at 203 (citation omitted).

[36] *Id.* at 205 FN3.

Jones, who resided in the Republic of Cyprus and was a citizen of the United Kingdom, was appointed lead plaintiff. An opponent movant, an Israeli institutional investor referred to as the Sphera Fund, argued that Jones was inadequate to serve as lead plaintiff because he might be subject to a unique *res judicata* defense. The *Bigband* Court rejected this argument, finding that the Sphera Fund failed to submit sufficient evidence that would allow the Court to determine whether or not a Cypriot court would give binding effect to an American judgment.[37] The *Bigband* Court noted, for instance, that the Sphera Fund failed to provide an authenticated version of the Cypriot Civil Procedure Rules, instead citing to a questionable web-site that purportedly contained translations of Cypriot laws, and presented no expert testimony indicating that a Cypriot court would not enforce a judgment or settlement in the instant case.[38] Lastly, the *Bigband* Court noted that the same *res judicata* concerns existed with respect to the Sphera Fund as it provided "no specific argument that an Israeli court would give preclusive effect" to a judgment in the instant case.[39] The *Bigband* decision can be used as a guide to determine the type of evidence courts require, such as expert testimony and authenticated laws of the foreign country, when making a decision with respect to whether *res judicata* renders a foreign investor inadequate to serve as lead plaintiff.

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37 *Bigband Networks, Inc.*, Docket No. 07-cv-05101 (SBA) at p. 12.

38 *Id.* at *8.

39 *Id*.

II. Challenges Facing International Investors At The Motion to Dismiss And Class Certification Stages

Foreign investors may be subject to attack at the motion to dismiss stage and the class certification stage, often for the same reasons as discussed above, but the outcome at this point is critical since foreign investors may be excluded from the class.

A. Subject Matter Jurisdiction Challenges On A Motion To Dismiss

In *In Re Vivendi Universal, S.A. Securities Litigation*, the plaintiffs – foreign investors who purchased shares of Vivendi, a French corporation, in a foreign market – survived a motion to dismiss based on lack of subject matter jurisdiction.[40] During the class period, Vivendi made allegedly false and misleading statements both within the U.S., including in SEC filings, and abroad. The defendants argued that the defendants' U.S. based conduct did not directly cause the plaintiffs' financial injury, and noted in particular that Vivendi did not make regular quarterly SEC filings and had only one corporate officer in the U.S. until certain of the individual defendants moved to the U.S. during the class period.[41] The district court rejected the defendants' arguments and instead found that the U.S.-based conduct was sufficient to confer subject matter jurisdiction.[42] In particular, the court noted that Vivendi took on $21 billion in debt to finance its attempted acquisition of numerous U.S. companies such as Universal Studios and USA Networks, all the while issuing false and misleading statements via its SEC filings and press releases in order to reassure investors that it had sufficient cash flow to

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40 *In re Vivendi Universal*, S.A., 381 F. Supp. 2d 158, 165, 192 (S.D.N.Y. 2003).

41 *Id.* at 169.

42 *Id.* at 170.

manage its debt.[43] The court also noted that Vivendi executives who were individual defendants spent half of their time in the U.S. during part of the class period in an effort to increase U.S. investment in Vivendi, while Vivendi's former CEO and CFO decided to move to the U.S. As such, the court stated that their U.S.-based conduct "c[ould] hardly be deemed merely preparatory" and that it was reasonable to infer that the alleged fraud on the American exchange was a "'substantial' or 'significant contributing cause' of [foreign investor's] decision[s] to purchase [Vivendi's] stock" abroad.[44]

Courts have held there is no subject matter jurisdiction, however, where the complaint does not allege that any significant fraudulent conduct occurred in the U.S., or where the U.S.-based conduct did not directly cause the plaintiffs' harm. In *Nikko Asset Mgmt. Co. v. UBS AG*,[45] for instance, Japanese entities brought claims alleging that they had been defrauded in connection with their purchase in Japan of credit notes sold to them by UBS Japan, a Japanese affiliate of the UBS investment bank. The notes were intended to transfer the risk of Enron-related transactions, and the fraud claims focused

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43 *Id.* at 169-170.

44 *Id.* at 169 -170. *See also In re Alstom SA Sec. Litig.*, 406 F. Supp. 2d 346, 377 (S.D.N.Y. 2005) (finding subject matter jurisdiction over one of two frauds alleged by "foreign cubed" plaintiffs where plaintiffs asserted, among other things, that defendants filed false and misleading reports and financial statements with the SEC. The court explained that the defendants' domestic conduct "form[ed] an essential link … which contributes substantially to the consummation of the alleged securities violation" abroad.); *Yung v. Integrated Transp. Network Group*, No. 00 CV 3965 (DAB), 2001 U.S. Dist. LEXIS 24715 (S.D.N.Y. Sept. 5, 2002) (finding subject-matter jurisdiction over claims of Hong Kong plaintiffs who purchased shares in Hong Kong of an American company; court noted that the conduct test was satisfied where defendant company's SEC filings were a central part of the fraud, the purchase agreement between plaintiffs and the company referenced U.S. securities laws, and the company communicated with plaintiffs from the U.S. to urge their investment in the company); *Cromer Fin. Ltd. v. Berger*, 137 F. Supp. 2d 452, 480-481 (S.D.N.Y. 2001) (exercising subject-matter jurisdiction over securities fraud claims of foreign plaintiffs brought against an off-shore investment fund, as well as against Bermuda-based auditors and fund administrators; conduct test was met where the investment manager and advisor for the fund carried out the alleged fraud in the U.S., Bermuda defendants transmitted false financial statements into the U.S., the fund's offering memorandum was sent to U.S. entities and the Bermuda defendants traveled to the U.S. to meet with the fund's advisor).

45 303 F. Supp. 2d 456, 457-458 (S.D.N.Y. 2004).

on American UBS affiliates' alleged knowledge of the impending Enron crisis and the failure to disclose this to plaintiffs. The court held that it did not have subject matter jurisdiction over the claims, noting that the UBS debt issuance program was merely a "non-fraudulent preparatory activity" and that plaintiffs' losses were not "directly caused" by any fraudulent conduct in the U.S.[46]

Similarly, in *Tri-Star Farms Ltd. v. Marconi PLC*,[47] the plaintiffs, investors in a British corporation, alleged that the corporation and certain individuals fraudulently inflated the market price of the corporation's stock. Nearly all of the alleged fraudulent conduct, however, occurred in the United Kingdom and the only U.S. conduct alleged was the filing of two forms with the SEC containing purportedly false and misleading information.[48] The court granted motions to dismiss for lack of subject matter jurisdiction over the claims, stating that the defendants' U.S. conduct was "insubstantial

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46 *Id.* at 466. *See also Rhodia*, 2007 WL 2826651 at *9 (district court lacked subject matter jurisdiction over claims of foreign purchasers of stock in French chemical corporation on foreign exchanges where U.S. conduct, including assignment of environmental liabilities to French corporation, was not fraudulent in and of itself, but was instead the object of alleged fraudulent misrepresentations); *In re National Austl. Bank*, 2006 WL 3844465 at *1, 8 (subject matter jurisdiction over foreign investors' claims could not be based on allegation that the foreign corporate defendant's U.S. subsidiary's fraudulent projections formed the basis of the corporate defendant's fraudulent statements disseminated abroad); *Blechner v. Daimler-Benz AG*, 410 F. Supp. 2d 366, 369-370 (D. Del. 2006) (refusing to exercise subject matter jurisdiction where "[t]he conduct asserted … did not occur predominantly in the [U.S.]; it occurred primarily in Germany. Additionally, while the acquired corporation was an American corporation and while some of the shareholders whose solicitation was sought were American or residing in the United States, the case before the Court concerns those shareholders who have no connection to the United States and who did not surrender their shares to an American market."); *Froese v. Staff*, 02 CV 5744, 2003 WL 21523979, at *2 (S.D.N.Y. July 7, 2003) (insufficient grounds existed for jurisdiction where "direct cause" of German plaintiff's losses in connection with his purchase of shares of a German corporation on a German securities exchange was allegedly fraudulent statements made in Germany. Allegation that U.S. subsidiary's improper accounting caused German company's financial statements to be false did not change the result); *Societe Nationale d'Exploitation Industrielle des Tabacs et Allumettes v. Salomon Bros. Intern. Ltd.*, 928 F. Supp. 398, 403-407 (S.D.N.Y. 1996) (granting motions to dismiss for lack of jurisdiction over securities and commodities fraud claims brought by French investor against British broker, and its American affiliates, where case was based on fraudulent statements made in Europe while U.S. conduct was only "secondary" or "ancillary").

47 225 F. Supp. 2d 567, 569 (W.D. Pa. 2002).

48 *Id.* at 577.

in comparison to the conduct that purportedly occurred in the United Kingdom and could not have played a significant role in furtherance of any fraud perpetrated against the foreign investors."[49]

B. Subject Matter Jurisdiction Challenges At The Class Certification Stage

Courts have certified classes including foreign-cubed investors where the complaints included allegations that significant fraudulent conduct occurred in the U.S. and/or contributed to the plaintiffs' financial losses. In *In re Nortel Networks Corp. Sec. Litig.*,[50] for example, the defendants argued that foreign purchasers of the foreign corporate defendant's stock should be excluded from the proposed class because the court lacked subject matter jurisdiction over their claims. The court found that the defendants' U.S.-based activities – which included carrying out risky financing deals and extending financing to uncreditworthy U.S. customers in an effort to artificially boost the corporate defendant's reported revenues – were sufficient to satisfy subject matter jurisdiction and certified a class including the foreign purchasers.[51]

Similarly, in *In Re Gaming Lottery Sec. Litig.*,[52] defendants argued on class certification that the court lacked subject matter jurisdiction over the claims of four Canadian proposed class representatives who had purchased the foreign corporate

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[49] *Id.* at 577-578. *See also Baan Company Sec. Litig.*, 103 F. Supp. 2d 1, 10 (plaintiffs brought claims on behalf of purchasers of stock of Dutch company with offices in the U.S. whose stock traded on both U.S. and Dutch exchanges. The only fraudulent actions alleged to have taken place in the U.S. were the filing of forms with the SEC and possibly the issuance of press releases. Neither action was a "substantial" or "contributing factor" to investors' decision to purchase stock and could not form a basis for jurisdiction.).

[50] No. 01 Civ. 1855 (RMB), 2003 WL 22077464, at *7 (S.D.N.Y. Sept. 8, 2003).

[51] *In re Nortel Networks*, 2003 WL 22077464 at *7.

[52] 58 F. Supp. 2d 62, 73 (S.D.N.Y. 1999).

defendant's stock in the Canadian securities market. The court rejected the defendants' argument, stating the corporate defendant could be held liable for injuries to foreign plaintiffs that the defendant caused by its "considerable conduct" in the U.S., which included the deception of a U.S. regulatory agency and the illegal operation of a U.S. subsidiary.[53]

C. ***Res Judicata* Challenges at the Class Certification Stage**

One of the requirements for class certification under Rule 23(b)(3) of the Federal Rules of Civil Procedure is "the class action device must be superior to any other method of adjudication." The superiority requirement will not be met if a court's judgment neither protects a prevailing defendant from re-litigation nor grants a plaintiff an enforceable damage judgment.[54]

The argument concerning *res judicata* will likely appear during class certification if members of the class are comprised of foreign investors. Although some courts have applied the "near certainty" test (*i.e.*, defendant must prove with "near certainty" that a foreign court would not enforce a U.S. class action judgment),[55] more recently, in *In re*

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[53] *Id.* at 73-74. *See also In Re Scor Holding (Switzerland) AG Litigation*, No. 04 Civ. 7897 (DLC), 2008 WL 608606 at *2-9 (S.D.N.Y. March 6, 2008) (holding on class certification that foreign cubed plaintiff failed to establish grounds for the exercise of subject matter jurisdiction where the fraud was "masterminded" overseas and the bulk of the fraudulent acts occurred overseas; foreign cubed plaintiff failed to demonstrate that defendants' U.S.-based conduct, including misleading SEC filings, was more than "incidental" or that such conduct directly caused the losses claimed by foreign plaintiff).

[54] *See Glaxosmithkline*, 246 F.R.D. at 203 ("If this Court's judgment on the merits neither protects a prevailing defendant against relitigation in Germany, nor grants a prevailing German plaintiff an enforceable damage judgment, then for those litigants a class action is not 'superior'…. Rather, it is a waste, and their presence in the class…may inflict burdens on the administration of the action.") (citation omitted).

[55] *See, e.g., Bersch v. Drexel Firestone, Inc., et al*, 519 F.2d 974 (2d Cir. 1975); *In re Royal Dutch/Shell Transp.*, 380 F. Supp. 2d at 547 (requiring defendants to prove with near certainty that a court would not give *res judicata* effect to a U.S. judgment); *In re Cable & Wireless*, 321 F. Supp. 2d at 766 (same).

Vivendi Universal, S.A., Judge Holwell of the U.S. District Court for the Southern District of New York found the "near certainty" test not particularly useful and instead evaluated the risk of non-recognition by a foreign court along a continuum. Judge Holwell noted, however, that "[t]he closer the likelihood of non-recognition is to being a 'near certainty,' the more appropriate it is for the Court to deny certification of foreign claimants."[56]

In *Vivendi*, members of the class hailed from France, England, Germany, Austria, the Netherlands, and the United States. In determining whether the foreign investors should be excluded from the class, the Court found that "[w]here plaintiffs are able to establish a probability that a foreign court will recognize the res judicata effect of a U.S. class action judgment, plaintiffs will have established this aspect of the superiority requirement. Where plaintiffs are unable to show that foreign court recognition is more likely than not, this factor weighs against a finding of superiority and, taken in consideration with other factors, may lead to the exclusion of foreign claimants from the class."[57] After reviewing the competing experts' declarations and the laws of each country, the *Vivendi* Court determined that plaintiffs had shown that, more likely than not, a judgment would be recognized in France, England, and the Netherlands. The *Vivendi* Court noted, however, that plaintiffs failed to show that either Germany or Austria would grant such recognition. As such, the *Vivendi* Court excluded German and

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[56] *In re Vivendi Universal, S.A.*, 242 F.R.D. 76, 95 (S.D.N.Y. 2007). It should also be noted that *Vivendi* appears to switch the burden from defendants to plaintiffs since courts applying the "near certainty" test have placed the burden of proof on defendants.

[57] *Id. See also Cromer Fin. Ltd. v. Berger, et al.*, 205 F.R.D. 113, 135 (S.D.N.Y. 2001) (finding class action superior when evidence indicated "at most a 'possibility' that a defense verdict will have no *res judicata* effect abroad") (citation omitted). Apparently relaxing this standard even further, the Court in *In re Turkcell Iletisim Hizmetler, A.S. Sec. Litig.*, 209 F.R.D. 353, 360 (S.D.N.Y. 2002), stated that class certification is proper "if there is some possibility that a class action judgment would be enforceable-or at least have some substantial effect-in the foreign jurisdiction at issue."

Austrian investors from the class but allowed the French, English, and Dutch citizens to remain in the class since courts in those countries would, more likely than not, recognize the enforceability of a judgment or settlement in a U.S. class action lawsuit.[58]

CONCLUSION

When participating in U.S. securities class actions, foreign plaintiffs should be mindful of the many hurdles they may face, potentially starting at the lead plaintiff stage and continuing through the class certification stage. Defendants have a number of arrows in their quiver to launch against foreign plaintiffs – attacks such as *res judicata* and subject matter jurisdiction. Nevertheless, a growing number of foreign plaintiffs will

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[58] *In re Vivendi*, 242 F.R.D. at 105-106. Although defendants ordinarily assert the issue of *res judicata* as a failure to satisfy the superiority requirement, at least one defendant has asserted it as an attack on whether or not a lead plaintiff would be an adequate class representative under Rule 23(a)(4) of the Federal Rules of Civil Procedure. In *Marsden v. Select Med. Corp.*, 246 F.R.D. 480, 485-486 (E.D. Pa. 2007), defendants argued that one of the lead plaintiffs, an Austrian company, was an inadequate class representative since a judgment would not have preclusive effect in Austria. The *Select Medical* Court rejected this argument, distinguishing the instant case from *Vivendi* and others like it since the Court was not "faced with an issue of borderline subject matter jurisdiction" as all of the misrepresentations were made in the U.S. by an American company whose shares traded on an American stock exchange. *Id.* at 486. The *Select Medical* Court further noted that "it is far from clear how an Austrian court would even have jurisdiction over a suit arising from the alleged fraud here." *Id.* In addition, the *Select Medical* Court noted that, despite the extensive amount of time for discovery, defendants did not consult with any experts on Austrian law to determine the effect a U.S. judgment would have in Austria. "Such a speculative argument is simply not sufficient to support the exclusion of [lead plaintiff] or an unknown number of foreign investors" from the class. *Id.*

In addition, a defendant in *In re U.S. Fin. Sec. Litig.*, 69 F.R.D. 24, 48 (S.D. Cal. 1975), argued that "due process" precluded a class action when the class members were not citizens or residents of the United States because a judgment would not be binding on the foreign plaintiffs. The Court denied this argument because of a number of practical difficulties a foreign plaintiff would face in bringing suit in a foreign court. *See id.* at 52. For instance, the Court noted that: (1) literally thousands of documents were located exclusively in the United States and would need to be translated in most countries, (2) a U.S. judgment, although perhaps not given *res judicata* effect, would nonetheless be evidence and could be utilized by defendant as a defense, (3) defendant was not physically present in several of the countries and had no assets present so even if a judgment was entered by a foreign court, it would be unenforceable, and (4) no lawsuit had been filed outside the United States to date. *Id.* at 48-52. As such, the *U.S. Financial* Court granted plaintiffs' motion for class certification despite the fact that most, if not all, of the plaintiffs were foreigners. *Id.*

likely continue to play active roles in U.S. securities fraud suits and face such challenges head on.