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Second Circuit Upholds Jurisdictional Dismissal of Securities Class Action Brought by Foreign Plaintiffs Who Purchased Foreign Issuer's Securities on Foreign Exchanges

Foreign public companies doing business in the United States have been struck by a plague of American securities class actions in recent years—a species of lawsuits called “foreign-cubed” or “f-cubed” litigation, so named because *foreign* investors bring these suits against *foreign* issuers to recover losses from purchases on *foreign* exchanges. Where the federal securities laws’ territorial limits should be drawn is a question that different federal district judges have decided in different ways, and the securities plaintiffs’ bar has taken full advantage of the resulting confusion to coerce billions of dollars in settlements from foreign issuers. As a result, as the *Wall Street Journal* has described (link [here](#)), foreign investors increasingly have been “pursuing in the U.S. the kinds of big-money lawsuits still largely discouraged in their own countries.” The trend has accelerated in recent weeks and months, as plaintiffs’ lawyers and their clients have targeted foreign financial institutions that have suffered significant losses on mortgage-related investments in the United States.

But late last week, in *Morrison v. National Australia Bank Ltd.*, No. 07-0583-cv, 2008 WL 4660742 (2d Cir. Oct. 23, 2008) (link to slip opinion [here](#)), the United States Court of Appeals for the Second Circuit provided a welcome clarification of the law governing these “foreign cubed” cases. The court affirmed the dismissal of one such lawsuit against a foreign financial institution and, in doing so, established an important precedent that carefully circumscribes the ability of the plaintiffs’ bar to bring similar suits in the future. The case was closely watched by the securities industry and by trade organizations. A number of *amici curiae*, including the Securities Industry and Financial Markets Association, the United States Chamber of Commerce, the Association Française des Entreprises Privées, the Association of Corporate Counsel, and the Washington Legal Foundation, filed or joined briefs supporting the defendants. The Court of Appeals invited the Securities and Exchange Commission to weigh in, and the SEC did so, with a brief supporting the plaintiffs. This Firm represented NAB in the case.

The significance of the case stems from the congruity of its facts with those of many other “foreign-cubed” securities cases and, of particular relevance today, its striking similarity to some of the securities class actions that have been brought against foreign financial institutions in the wake of the ongoing global financial crisis. The defendant issuer was National Australia Bank, Australia’s oldest and largest bank, whose stock price on the Australian Stock Exchange dropped significantly in 2001 because of a large loss it had taken at HomeSide Lending, a Florida mortgage servicing company that was then a wholly-owned subsidiary of NAB. The loss came from NAB’s decision to write down the value of HomeSide’s mortgage servicing rights, highly volatile and thinly-traded instruments that can be valued only with great difficulty through the use of complex predictive models. Australian purchasers of NAB’s ordinary shares brought a class action against NAB in the Southern District of New York, contending that a worldwide foreign class was proper under American law because “fraud” allegedly had occurred at HomeSide, in Florida.

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This factual pattern is typical of many cases that have been brought against foreign issuers, both financial and non-financial: A foreign company, most or all of whose equity trades on foreign exchanges, suffers and discloses a business reversal in its operations in the United States. The company's stock price falls on the foreign exchanges. American plaintiffs' lawyers succeed in recruiting foreign shareholders to file a class action against the foreign company in the United States, and then argue that the American securities laws should apply because the foreign plaintiffs suffered losses caused by "fraud" in the foreign company's American operations. Some district judges have dismissed claims like these; others have not. The rulings have been consistent in their inconsistency.

In *National Australia Bank*, the district court dismissed the case for lack of subject-matter jurisdiction, and in last week's decision, the Second Circuit affirmed. The Court of Appeals declined to adopt a "bright-line ban" that would "declin[e] jurisdiction over all 'foreign-cubed' securities fraud actions"; the court was "leery of rigid bright-line rules because we cannot anticipate all of the circumstances in which the ingenuity of those inclined to violate the securities laws should result in their being subject to American jurisdiction." Slip op. at 15, 16. The court nevertheless made clear that "we are an American court, not the world's court, and we cannot and should not expend our resources resolving cases that do not affect Americans or involve fraud emanating from America." *Id.* at 16. Accordingly, the court held that whether American law should apply "boils down to what conduct comprises the heart of the alleged fraud," and where that conduct occurred. *Id.*

The Court of Appeals concluded that the heart of the alleged fraud involved activity that took place in Australia. What mattered most was that "NAB's Australian corporate headquarters," not its American subsidiary, had "primary responsibility for the corporation's public filings, for its relations with investors, and for its statements to the outside world"; and so the company's actions "in Australia were, in our view, significantly more central to the [alleged] fraud" than the subsidiary's actions in Florida. *Id.* at 17. Similarly, the court emphasized that only a "lengthy chain of causation" linked "the American contribution to the [alleged] misstatements and the harm to investors," because the Florida subsidiary's "numbers had to pass through a number of checkpoints manned by NAB's Australian personnel before reaching investors." *Id.* at 18, 19. The court also noted that the absence of "any meaningful effect on America's investors or its capital markets . . . weighs against our exercise of subject matter jurisdiction." *Id.* at 18. "This particular mix of factors," concluded the court, "add[s] up to a determination that we lack subject matter jurisdiction." *Id.* at 19.

Given the typicality of the factual pattern it addressed, the Second Circuit's decision in *National Australia Bank* represents a significant victory for foreign companies. The ruling makes clear that the crucial consideration in determining whether a United States court can hear an "f-cubed" case is where the issuer prepares and issues its disclosures. When foreign investors suffer losses as the result of statements made in foreign countries by foreign issuers, the foreign investors will now find it very difficult to maintain actions under the American securities laws. If district courts faithfully follow *National Australia Bank*, much of the current wave of "f-cubed" litigation will have to be dismissed.

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