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SECURITIES LAW

Tips for Investors Considering Transnational Securities Litigation

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Special to the Legal

During recent decades, the securities markets have become increasingly internationalized, providing investors with an array of investment opportunities on the various exchanges around the world. In response, the extraterritorial reach of the United States securities laws has been developed by federal courts in cases commenced under U.S. law.

In a recent *New York Law Journal* article, a sister publication of *The Legal*, DLA Piper attorneys John Clarke and Keara Gordon note there has been a coinciding "increase in the frequency of overseas investors appearing as plaintiffs in securities class actions in the United States." While it is true that the federal securities laws enacted by Congress during the Great Depression generally protect investors from suffering losses as a result of fraud in connection with securities transactions executed on U.S. exchanges, some securities cases are more suitable than others for international investors. The purpose of this column is to identify certain practice points for European and international investors to consider when determining whether and how to participate in a transnational securities fraud class action.

COURTS DEVELOP GUIDELINES

U.S. courts have determined that the antifraud provisions of the federal securities laws apply to protect investors residing in the U.S. from suffering losses as a result of fraudulent exchanges of securities regardless of where the fraud arises or where the perpetrators reside. U.S. law will protect investors from harm when a fraud is "imported" into the U.S.

Investors who are not U.S. residents may bring a securities fraud claim in a U.S. court where fraudulent conduct that occurred in the U.S. caused the investor to suffer an economic loss. Courts have determined that the federal securities laws also protect investors around the world from fraud "exported" out from the U.S.

Applying these principles, courts have been reluctant to extend the federal securities laws to cases brought by so-called "foreign cubed" investors: non-U.S. investors seeking to assert securities fraud claims against non-U.S. corporations, alleging a fraud that occurred outside the country involving securities that are traded on non-U.S. exchanges. Such claims brought by international investors are generally dismissed by U.S. courts for lack of subject matter jurisdiction.

For example, in the *DaimlerChrysler* securities litigation before Judge Joseph J. Farnan Jr. in the District of Delaware, the case against the German corporation was sustained on behalf of all U.S. investors and proceeded to a settlement of $300 million. But because the court concluded that the wrongful conduct took place outside of the U.S. and because international investors did not trade their shares on a U.S. exchange, the court determined that exercise of subject matter jurisdiction over a subsequent case brought by only European investors was inappropriate. That case was consequently dismissed. More recently, in the *Parmalat* securities litigation before Judge Lewis A. Kaplan of the Southern District of New York, the court dismissed European investors' claims against the Italian dairy company's auditors and investment banks because those defendants were accused of a role in Parmalat's fraud that was entirely outside of the country.

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Such precedent underscores the principle that European and international investors are best served by the federal securities laws where the investors assert claims against U.S. corporations or where the fraudulent conduct occurred in the country. For this reason, European and other international investors should scrutinize recommendations that they seek lead roles in cases against non-U.S. corporations; especially where the alleged fraud occurred outside the U.S. Therefore, an important practice point concerning jurisdictional issues arising in U.S. securities fraud class actions is that cases are generally more suitable for European or other international investors where the principal defendant is a U.S. corporation or where the alleged fraudulent conduct largely occurred in the country.

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PROCEDURAL ISSUES WITH CLASS ACTIONS

Courts have also been clarifying issues under Rule 23 of the Federal Rules of Civil Procedure, which provides for class certification, where the class sought to be certified includes investors who reside outside the U.S. In addition to the standard "rigorous analysis" necessary for a court to satisfactorily certify a class under the rule, where the putative class includes investors from outside the U.S., courts have been asked to determine whether a U.S. class action judgment would be binding upon those investors in their respective native jurisdictions.

Defendants have contended that courts in certain countries will not recognize the binding nature of a U.S. class action judgment in securities cases involving non-U.S. investors. As a result, defendants contend, if a U.S. class action is dismissed, taken to judgment or settled, they would not be able to assert claim preclusion as a defense to bar subsequent actions in those countries in which the European or other non-U.S. investors reside. Doubts about claim preclusion in European and other jurisdictions tend to tip the scale against certification of a class including investors from those jurisdictions.

For example, in the *Vivendi Universal* securities litigation, Judge Richard J. Holwell of the Southern District of New York surveyed precedent addressing transnational claim preclusion under Rule 23 and evaluated the evidence offered by the parties with regard to jurisprudence in France, England, Germany, Austria and the Netherlands. After a thorough review, the court determined that the class could include those investors outside the U.S. only where it is "more likely than not" that the investors' home jurisdictions would "give res judicata," or binding, effect to the class action judgment. The court ruled that the greater the likelihood that the jurisdiction will not recognize a U.S. class action judgment, the more appropriate it is for the court to deny claimants from that jurisdiction from being included in the class. Thus, the court concluded that the class could include U.S. investors and investors from France, England and the Netherlands. But, the court excluded from the class investors from Germany and Austria because the court was not able to conclude that German or Austrian courts would "probably … grant preclusive effect to any judgment or settlement issuing" from the class action.

"[T]he Court elects to proceed with caution and limit the class to foreign shareholders whose courts, in the unlikely event of successive litigations, are likely to give res judicata effect to any judgment herein. This double layer of security should allay defendants' legitimate concerns."

For this reason, European and other non-U.S. investors should scrutinize recommendations that they seek representative roles in U.S. class actions, especially where there exists doubts about whether an investor's home jurisdiction would recognize as binding the judgment or settlement. Therefore, a practice point addressing the binding effect of U.S. class action procedures is that European investors may consider a class case as suitable where courts in their native country will likely give full faith and credit to a U.S. class action judgment or settlement. Otherwise the investor may wish to consider an individual, non-class case as an alternative procedure.

EUROPEAN COURT PROCEDURES DEVELOP

European and other international investors may also consider legal procedures outside the U.S., including those in certain European jurisdictions. According to Clarke and Gordon, "within the past several years, a number of nations have adopted procedural mechanisms similar to the U.S. class action in important respects. [But b]ecause of perceived abuses of the American system, no other nation has embraced our model in all respects."

Perhaps the most notable such development is the 2005 amendment of the Netherlands Civil Code by the Dutch Act on the Collective Settlement of Mass Claims. While originally envisioned as a method for resolving large-scale torts, Clarke and Gordon explain that the amendment provides for court approved settlements similar to an "opt out" class action. In other words, according to Clarke and Gordon, the amendment provides a mechanism for defendants to settle claims asserted by European investors "who will be bound by settlements under the act unless they affirmatively act to exclude themselves."

For example, the amended Dutch law arguably worked to the advantage of Royal Dutch Shell, which was facing a securities fraud class action pending in the U.S. District Court for the District of New Jersey when it negotiated a settlement with a Dutch shareholder association and other European investors, each of whom opted out of the U.S. class action in order to participate in the process under Dutch law. The case exemplifies an effort by a defendant to achieve an international settlement in a European securities case; the U.S. *Royal Dutch Shell* securities litigation settled on behalf of U.S. investors shortly after the case settled in the Netherlands.

Pierre Gentin, managing director and head of litigation at Credit Suisse First Boston, remarked at a securities litigation conference in Manhattan that formal collaboration between U.S. firms that specialize in class action litigation and European law firms is, in part, driving the development of these new types of group procedures. According to Ianika Tzankova, professor and chair of comparative mass litigation at Tilburg University: "European investors have become more receptive to collaborations between their counsel and American lawyers partly because European investors have been more actively monitoring the corporate governance of the companies in which they are investing. Institutional investors monitor corporations in order to fulfill their fiduciary duties and, with regard to public pension funds, to preserve the rights of their beneficiaries. Shareholder voting is one way to monitor; another way is to become more involved in group securities litigation."

Where European and other international investors can use the pending threat of a U.S. class action to gain bargaining leverage with European defendants, they may seek to resolve their claims collectively in jurisdictions like the Netherlands. While each nation's procedures have their unique nuances, similar group or collective action procedures exist in Australia, Canada, England, Portugal, Denmark, Norway and Italy.

For this reason, European and other non-U.S. investors should scrutinize recommendations that they seek lead roles in U.S. class actions against European and other

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international corporations, especially where there exists a likelihood to negotiate a fair and reasonable resolution of the dispute in the investor's home jurisdiction or elsewhere, such as in the Netherlands. Thus, a practice point for considering the most suitable forum in which to seek a remedy for securities fraud perpetrated by a European corporation is that European or other international investors should consider whether the existence of a U.S. class action provides them with increased bargaining power with which to secure a fair and reasonable settlement using European or other group or collective legal procedures.

CONCLUSION

While institutional investors have become increasingly aware of the risk of leaving money on the table in securities class actions, investors outside of the U.S. should carefully scrutinize any recommendation to participate in a securities fraud class action pending in U.S. courts. The following practice points may guide such investors in their considerations:

• European and other international investors will generally face fewer jurisdictional challenges in cases where the principal defendant is a U.S. corporation or where the fraudulent conduct largely occurred in the country;

• European and other international investors will generally face fewer challenges to inclusion within a class where their home jurisdiction is likely to give res judicata, binding, effect to a U.S. class action judgment or settlement; otherwise the investor should consider an individual, non-class, case; and lastly,

• European and other international investors will generally benefit from increased bargaining power upon the existence of a U.S. class action and should consider whether such bargaining power may permit them to negotiate a fair and reasonable settlement in their home or other international jurisdiction.

These practice points are designed to assist European and international investors who seek to enforce anti-fraud rules in the transnational capital markets. By so seeking redress for securities fraud, investors promote a philosophy of transparency in corporate disclosure and combat the philosophy of "buyer beware." •