# Recent Second Circuit Decision: The Courthouse Door is Temporarily Shut, Though Still Left Ajar, for Foreign Securities Plaintiffs

National Bank of Australia purchased U.S. mortgage service provider HomeSide Lending Inc. in 1998. Three years later, the bank was forced to admit that its calculations on the amount of fees HomeSide was generating from servicing mortgages were overstated. This led to the bank announcing two write-downs in 2001 totaling $2.2 billion. As a result, both the bank's shares, which do not trade on U.S. exchanges, and its American Depository Receipts, which trade on the NYSE and make up only a small fraction of the bank's securities, dropped in value. Three plaintiffs who purchased shares abroad and a fourth who purchased the ADR's sought to represent two classes in the Southern District of New York.

The case presents the "vexing question of [the] extraterritorial application of the securities laws." This vexing question, however, is not new. Though there is conflict in the nuances of the proper test to be applied, U.S. federal courts will sustain subject-matter jurisdiction over a foreign-based lawsuit "if activities in this country were more than merely preparatory to a fraud and culpable acts or omissions occurring here directly caused losses to investors abroad." The plaintiffs had argued below that the fraud primarily occurred in the United States because HomeSide was based in Florida, even though the statements which investors relied upon were made and disseminated in Australia.

What is at the heart of the scheme as opposed to what is merely "preparatory" or "ancillary" can certainly be "an involved undertaking." The defendant and some amici argued for a "bright-line rule" dismissing these sorts of securities cases, because U.S. markets are substantially not at issue. Their biggest objection was the conflict between U.S. securities laws and those in other countries, such as Canada, which does not recognize the fraud on the market doctrine, or other countries where class actions are not allowed or difficult to bring. The United

States, under their "parade of horribles," could become the clearing-house for the world's securities fraud litigation if these sorts of actions were countenanced by the courts. On the other hand, plaintiffs argued that closing U.S. courts to these sorts of actions could actually harm U.S. competitiveness by increasing the migration of capital overseas.

The Second Circuit refused the "bright line rule," but nonetheless dismissed this suit. It held that the potential conflict noted by Defendants does not require the "jettisoning" of our prior precedent because conflict of laws "is much less of a concern when the issue is the enforcement of the anti-fraud sections of the securities laws than with such provisions as those requiring registration of persons or securities." On the former, he said, the "anti-fraud enforcement objectives" in different countries are "broadly similar." A categorical rejection of these sorts of actions, he said, "would conflict with the goal of preventing the export of fraud from America." Applying what has become known as the "conduct test," the court found that the heart of the fraud alleged here occurred outside the United States, and dismissed the suit for lack of subject matter jurisdiction.

This is a short-term victory for foreign companies, though not as large a victory as they had liked. As the lead counsel for the defendants noted, "[t]he court's decision makes clear that a paramount consideration in determining whether a U.S. court can hear [this sort of case] is whether the statements were made by the foreign issuer itself in the foreign country, and if that's the case, it is going to be very difficult for the plaintiffs to sustain the case." While this decision may have made some progress towards lessening the threat against foreign companies—for example, by shortening the chain of causation—the larger problem remains, because the Second Circuit clearly contemplates that there will be occasions where [foreign] transactions can be litigated here. According to one legal commentator, "[t]hat leaves considerable residual fear in the hearts of a foreign issuer who does not have to face the prospect of class litigation in their home country and thus only encounters it by entering the United States." While people like to blame the "already significant migration" of capital off shore on Sarbanes-Oxley, he said, "that doesn't do much compared with the threat of a billion dollar class action."

The Second Circuit Decision is *Morrison v. National Australia Bank Ltd.*, 07-0583-cv