

The Globalization of U.S. Securities Class Actions and U.S. Securities Law Enforcement

SPEAKERS:

Michael J. Malone

Andrew C. Hruska

Russell G. Ryan

Wednesday, October 8, 2008
12:30 – 1:30 p.m. Eastern time

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Speaker Biography



Michael J. Malone
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Michael Malone is a partner in the Litigation Practice Group in King & Spalding's New York office. Previously, he was head of the Litigation Department at Battle Fowler LLP in New York, where he had been a partner since 1985.

Mr. Malone is known nationally for his work on complex commercial litigation matters, including securities class action defense, general securities, corporate control and antitrust issues, investment banking disputes and other substantial corporate litigations, arbitrations, and government investigations. He is an expert in both trial and appellate practice and has been repeatedly selected by his peers for inclusion in the *The Best Lawyers in America*.

Prior to his tenure at Battle Fowler, Mr. Malone was a litigation associate at Cravath Swaine & Moore, where he worked on many major commercial litigations. At Cravath, he was a member of the trial team representing the City of New York in challenging the constitutionality of the U.S. Census because of its systematic undercounting of minorities. That case eventually led to the restructuring of counting procedures by the U.S. Census Bureau.

Mr. Malone received his J.D., *cum laude*, from Fordham Law School in 1977, where he was an Editor of the law review, and his A.B. from Colgate University in 1972. He began private practice after a clerkship with the Hon. William H. Mulligan in the U.S. Court of Appeals for the Second Circuit.

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Andrew C. Hruska
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Andrew Hruska is a litigation partner in King & Spalding's New York office and a member of the firm's Special Matters and Government Investigations Practice Group. Mr. Hruska's practice focuses on criminal and regulatory litigation and investigations, complex civil litigation, and internal investigations. Since leaving the Justice Department, Mr. Hruska has represented major financial service and industrial companies in enforcement investigations by the Justice Department, the U.S. Attorneys' Offices for the Southern and Eastern Districts of New York, the New York Attorney General's Office, the New York County District Attorney's office, the SEC, the IRS, the Treasury Department's Office of Foreign Asset Control, the New York Federal Reserve Bank, the U.S. Department of Labor and the New York Stock Exchange.

Before joining King & Spalding, Mr. Hruska served as the Chief Assistant U.S. Attorney for the Eastern District of New York, overseeing both the criminal and civil divisions. In that capacity he supervised the office's significant corporate fraud offensive, including the investigations of Computer Associates and Symbol Technologies. Mr. Hruska was appointed Acting United States Attorney for the prosecution of the New York Racing Association on tax conspiracy charges. Mr. Hruska personally led the criminal investigation of the fatal Staten Island Ferry crash of October 15, 2003 that resulted in the manslaughter conviction of New York City's Ferry Service Director.

Mr. Hruska graduated, *cum laude*, from Yale College and received his law degree from Yale Law School. He is a member of the bar of the State of New York, the Southern and Eastern Districts of New York, the Second, Tenth and D.C. U.S. Circuit Courts of Appeals and the United States Supreme Court.

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Russell G. Ryan
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Russell Ryan is a partner with King & Spalding's Special Matters and Government Investigations group in Washington, D.C. His practice focuses primarily on SEC enforcement investigations, corporate internal investigations, and related corporate governance issues.

Mr. Ryan joined King & Spalding in February 2004 after a 10-year career in the SEC's Division of Enforcement, including his last three years as Assistant Director of the Division. While at the SEC, he investigated, litigated, and supervised a broad range of enforcement matters involving public company accounting and disclosure, auditor independence, Regulation FD, Foreign Corrupt Practices Act (FCPA) compliance, insider trading, broker-dealer regulation and supervision, Internet fraud, micro-cap stock manipulation, and "prime bank" fraud. Along with other members of the Division of Enforcement, he received the SEC Chairman's Award for Excellence in 2002.

Before joining the SEC in 1994, Mr. Ryan was a corporate and securities litigator with Willkie Farr & Gallagher, where he represented companies, broker-dealers, accounting firms, and individuals in private securities litigation, SEC enforcement matters, and other proceedings in both federal and state courts. He began his legal career as law clerk to the Honorable Henry Bramwell of the United States District Court for the Eastern District of New York.

Mr. Ryan earned his undergraduate degree, *summa cum laude*, at Boston College, and his law degree at St. John's University School of Law, where he was Executive Articles Editor of the *St. John's Law Review*.

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- **In the increasingly globalized world economy, U.S. securities class actions have become one of America's most vigorous new exports**

- **The most notable development has been the dramatic increase in U.S. Securities class actions filed in the U.S. By what are called “f-cubed” plaintiffs. These are class actions –**

- Against **foreign** issuers
- On behalf of a class of **foreign** shareholders
- Who purchased the shares on **foreign** exchanges

- **The number of securities class actions filed against foreign private issuers in 2007 was 27, almost double the 2006 filings.**

- **2 of the top 10 securities class action settlements of all time have been by foreign corporations**
 - Royal Ahold NV — \$ 1.1 Billion
 - Nortel — \$ 2.2 Billion

➤ **The risk of being subjected to U.S. Securities class actions is particularly onerous because typically only a small percentage of foreign private issuer shares are traded in U.S.**

- Just 2% to 15% of total outstanding shares of the corporation may be traded on U.S. exchanges
- Nevertheless, claims asserted on behalf of **all** shareholders of the foreign corp. Are decided in “opt out” U.S. class action

➤ **Plaintiffs’ class action firms have undertaken major PR and marketing initiatives in Europe**

- Joint ventures with European law firms
- Successful overtures to major European financial institutions and banks
- PR and political alliance with activist shareholder groups

➤ **The success to date of the plaintiffs bar in persuading U.S. courts to act as forums in securities class actions is having profound impact abroad politically, legally and judicially. Reactions include:**

- Applause by activist shareholder groups
- Resentment by some as “U.S. Judicial imperialism”
- Withdrawal from U.S. Market by some foreign companies
- Reexamination by many European countries of whether to adopt some modified form of class action procedures

➤ **Foreign private issuers continue to question whether the benefits of listing their securities on U.S. exchanges outweigh the risks and costs**

- Sarbanes-Oxley
- Conversion/reconciliation of US GAAP and foreign GAAP (Eliminated by SEC rule in November 2007)
- SEC, DOJ enforcement
- Subject to securities class actions in U.S.

➤ **Commission on regulation of U.S. capital markets in the 21st century found:**

- The U.S. legal and regulatory environment is critical in discouraging foreign companies from accessing U.S. capital market.
- The U.S. class action enforcement system cited by foreign companies as the most important reason they do not want to list their share in the U.S.

➤ **In 2007 more than 100 FPI's deregistered from filing in U.S. The majority of deregistrants were from relatively mature markets in Europe.**

➤ **Source – Cornerstone pp. 55-56**

➤ **U.S. style class action procedures are unknown or even contradictory to the law and policy of most foreign countries.**

- Contingency fees
- No “loser pays” rule
- Extensive and expensive discovery procedures
- Opt-out class action procedure
- Jury trials
- Potential for massive and devastating damage awards

➤ **Class actions are not recognized in the Netherlands, yet Royal Dutch Shell settled a securities class action in a Netherlands court for \$450 million in 2007.**

- **By novel use of its own legal procedures the Netherlands avoided certification of world wide class in new jersey against the most prominent Dutch corporation.**
- **U.S. Court later dismissed “F-Cubed” class action for lack of subject matter jurisdiction. *In re Royal Dutch/Shell Transport Sec. Lit.*, ____ F.Supp. 2d ____ (D.N.J. Nov. 13, 2007).**

➤ **Many countries have reacted with legislation**

- **France** — A bill to authorize class actions was submitted for consideration in 2006. The bill was withdrawn in 2007 and the Sarkozy administration has expressed hostility to US style class actions
- **Denmark** — Began “opt-in” class actions in 2008. Judge may determine “opt-out” class in appropriate in a specific case but a public authority must act as class representative.
- **Germany, Italy, South Korea, India** and **Nigeria** have all considered or passed legislation to permit some form of class action procedures of various types.
- [add others.]

➤ **Three key points in securities class action where the court examines the issues posed by the “F-Cubed” plaintiffs:**

- Motion to dismiss for lack of subject matter jurisdiction
- Motion to appoint lead plaintiff
- Motion to certify class of “F-Cubed” plaintiffs

- **The securities laws themselves do not state whether they have extra territorial application.**
- **To establish subject matter jurisdiction in U.S. courts, plaintiff must satisfy one of two tests used to determine whether laws apply to foreign securities transactions – the “effects” test or the “conduct” test.**

- **In class actions involving an “F-Cubed Class” the “Conduct” test applies.**
- **“Conduct” test requires:**
 - (1) Foreign defendant’s acts in U.S. must constitute significant fraudulent conduct; not merely conduct “preparatory” or “peripheral” to fraud
 - (2) The U.S. activities must be direct cause of plaintiff’s claimed losses

➤ **Application of conduct test not uniform**

- *Bersch v. Drexel Firestone, Inc.*, 579 F.2d 974 (2d Cir. 1975)
- Fifth, Seventh, D.C. Circuits follow Second Circuit - but these Circuit decisions are not recent
- Third, Eighth, Ninth Circuits “some lesser quantum of conduct” than the Second Circuit

➤ **More recent decisions within second circuit weigh various factors**

- *In re Alstom SA Sec. Lit.*, 406 F.Supp 2d 346, 375-76 (SDNY 2005)
- *In re Nortel Corp. Sec. Lit.*, 2003 WL 20077464, at 8 (SDNY Sept. 8, 2003) (degree of defendant’s economic activity connected to U.S. seen as key)
- One Second Circuit case suggests blending conduct and effects tests. *ITOBA Ltd. v. LEP Group PLC*, 54 F.3d 118 (2d Cir. 1995) (“admixture” of the two tests “gives better picture” of whether U.S. involvement justifies jurisdiction)

➤ **Despite some differences in stating and applying conduct test, a number of recent decisions have been fairly strict in rejecting subject matter jurisdiction of f-cubed claims:**

- *In re National Australian Bank Securities Lit.*, 2006 U.S. Dist. LEXIS 94162 (S.D.N.Y.) (Appeal to Second Circuit pending)
- *In re Rhodia S.A. Securities Litigation*, 531 F. Supp.2d 527 (S.D.N.Y. 2007)
- *In re Astrazeneca Sec. Lit.*, 2008 WL 2332325 (S.D.N.Y. June 3, 2008)

➤ **Appointment of lead plaintiff**

- Under PSLRA plaintiff with largest financial interest and which meets Rule 23 requirements is presumptive lead plaintiff.
- Can rebut presumption if that plaintiff:
 - » Would not “fairly and adequately” protect interests of class; or
 - » Would face unique defenses compared to other class members
- Sophisticated class counsel and proposed “F-Cubed” lead plaintiff can usually surmount challenge to “fair and adequate representation”
- Whether “F-Cubed” lead plaintiff will face serious subject matter jurisdiction challenge is bigger obstacle

➤ **Appointment of lead plaintiff** (*cont'd*)

- Some courts override presumption in favor of U.S. claimant as lead plaintiff. *In re Royal Ahold N.V.*, 219 F.R.D. 343, 352 (D. Md. 2003)
- Other courts appoint “F-cubed” plaintiff as lead plaintiff despite coming SM jurisdiction challenge. *In Re Parmalat*, 376 F.Supp 472, 510-12 (SDNY 2005); *In Re Nortel Networks*, 2002 WL 14982116 (SDNY Feb. 4, 2002)
- Some appoint F-cubed claimant and U.S. claimant as co-lead plaintiffs; *In Re Cable & Wireless PLC*, 217 F.R.D. 372, 378 (ED. Va. 2003)

➤ **The class certification motion**

- To certify the proposed class plaintiffs must satisfy the requirements of 23(a):
 - » Numerosity
 - » Commonality
 - » Typicality
 - » Fairly and Adequately Protect Class Interests
- Plaintiff must also satisfy requirements of Rule 23(b)(3)
 - » Common issues of law and fact predominate
 - » Class action is superior to other available methods of adjudication

- **Defendants' res judicata concerns are addressed as part of the "superiority" inquiry: will a settlement or judgment of the claims of f-cubed plaintiffs be given preclusive effects by foreign courts**

- **The Evolving Standard for when the prospects for preclusive effect satisfy the superiority requirement:**
 - *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974 (2d Cir. 1975) ("Near Certainty" of Nonrecognition)
 - *In re Turkcell [IBESTIM HIZMETTER] A.S. Sec. Lit.*, 209 F.R.D. 353 (S.D.N.Y. 2002) (No dismissal if there is possibility of recognition in the relevant foreign country.)

➤ **The Evolving Standard** (*cont'd*)

- *In re Vivendi Universal, S.A. Sec. Lit.*, 242 F.R.D. 76, 95 (S.D.N.Y. 2007) (Plaintiffs must demonstrate foreign courts would “probably recognize” U.S. Judgment as preclusive)
- *In re Alstom S.A. Securities Litigation*, 03 Civ. 6595 (S.D.N.Y. Aug. 26, 2008) (Adopting *Vivendi* standard)

➤ **“Preclusive Effect” issues are major battlefield in current F-cubed litigation**

- Proper legal standard is still developing
- Rapidly changing views of foreign countries toward class recoveries makes for lively battle of experts in law of many foreign jurisdictions

➤ **“Preclusive Effect”** (*cont’d*)

- *Vivendi* decision of May 2007 — based on then current assessment of French Law, Court finds judgment in U.S. class action would probably be enforced in France
- *Alstom* decision of August 2008 — based on evidence of French legal developments after May 2007, Court finds U.S. class action judgment would probably not be recognized in France

➤ **The supreme court’s comity caution on the limits extraterritorial application of federal law:**

- *Hoffman La-Roche Ltd. v. Empagran S.A.*, 542 U.S. 155 (2004)
 - » (rejecting outstanding class action claims by foreign plaintiffs for injuries in transactions occurring outside U.S. commerce.)
- *Microsoft Corp. v. AT&T Corp.*, 1275 Ct. 1746 (2007)
 - » (refusing to fund US patent law infringement where relatively small amount of US conduct would become “springboard for liability” for related extraterritorial conduct and injury. To find otherwise could constitute an “act of legal imperialism.”)

Developments in Global SEC Enforcement

SEC Framework

- **SEC can compel testimony and documents on behalf of foreign securities enforcement authorities regardless of whether the facts suggest a violation of U.S. law [Exchange Act § 21(a)(2)]**
- **SEC may provide foreign securities regulators with access to its non-public investigative files [Exchange Act § 24(c) and Rule 24c-1]**

SEC Framework *(cont'd)*

- **Memoranda of Understanding (MOUs)**
 - IOSCO Multilateral MOU (2002)
 - Bilateral MOUs with more than 30 countries
- **Ad hoc sharing and cooperation**
 - SEC typically makes about 500 requests for foreign assistance per year and responds to nearly as many from foreign regulators
- **SEC Enforcement Director Linda Thomsen has recently stated that global enforcement efforts will increase, along with agreements to facilitate the sharing of information between regulators across borders**

Mutual Recognition

- **Basic concept is to allow U.S. investors direct access to foreign trading markets and foreign investors direct access to U.S. trading markets**
- **Each mutually recognized foreign country must demonstrate a level of regulation and enforcement comparable to the U.S.**
- **Expect enhanced cooperation between SEC and securities regulators in countries with mutual recognition agreements**

Mutual Recognition *(cont'd)*

- **“Process Agreement” with Canada in summer 2008**
 - Intended to lead to mutual recognition agreement between the U.S. and Canada
- **Mutual recognition agreement with Australia announced in August 2008**
 - “Integral component” was an enhanced MOU to allow greater regulatory and enforcement cooperation

Pending Legislation

- **H.R. 6513 - The Securities Act of 2008**
 - Passed House vote in September 2008
 - Would make several significant changes in SEC enforcement practice generally (e.g. allow administrative penalties for securities law violations by companies and individuals not in regulated industries, and re-instate the concept of “collateral” cross-industry bars)
 - Would amend Exchange Act Section 24 to state that
 - » the SEC would not be deemed to have waived any privilege by sharing information with foreign securities regulators or foreign law enforcement authorities
 - » the SEC could not be compelled to disclose any information obtained from a foreign securities authority if the foreign authority represents in good faith that it is privileged

Other SEC Tools for Overseas Discovery

- **SEC has historically taken the position that a subpoena served on a U.S. company requires it to search for, collect, and produce information from overseas subsidiaries**
 - Raises significant privacy and data protection issues overseas, especially in European Union countries
- **Sarbanes-Oxley Section 106 effectively legislated the same result from international accounting firms that audit U.S. companies and/or register with the Public Company Accounting Oversight Board**

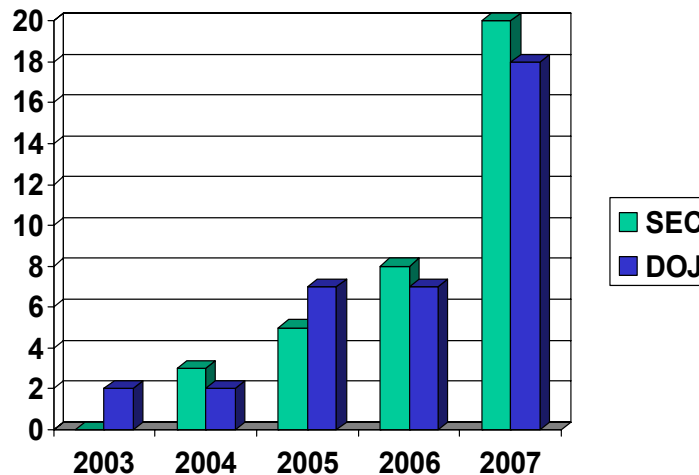
SEC Position on Territorial Reach of U.S. Securities Laws

- **Conduct that occurs in the U.S. – broadly interpreted**
- **Conduct by U.S. issuers or those acting on their behalf (e.g., FCPA)**
- **Conduct by overseas subsidiaries controlled by U.S. issuers that affects U.S. issuer's financial statements or accounting books and records**
- **Conduct that involves U.S. securities markets, including insider trading by foreigners in stocks listed on U.S. exchanges**
- **Conduct that otherwise harms U.S. investors**

Recent SEC Amicus Brief

- *Morrison v. National Australia Bank* (2d Cir.) (filed Sept. 2008)
- Shareholder suit in U.S. alleging overvaluation of assets by an Australian bank
- Overvaluation occurred at Bank's U.S. subsidiary, but Bank's stock traded only on Australian stock exchanges, so losses were sustained primarily overseas rather than in the U.S.
- District court dismissed for lack of jurisdiction, and SEC supported reversal as amicus
- SEC proposed standard: "The antifraud provisions of the securities laws apply to transnational frauds that result exclusively or principally in overseas losses if the conduct in the United States is material to the fraud's success and forms a substantial component of the fraudulent scheme."

Increased FCPA Enforcement



Recent FCPA Penalties and Disgorgement

- **2004 – ABB Ltd. – \$16 million**
- **2005 – Titan Corporation – \$28.5 million**
- **2007 – Vetco International – \$26 million**
- **2007 – Baker Hughes – \$44 million**

Emerging FCPA Enforcement Trends

- **Dramatically more enforcement activity and higher settlement amounts**
- **Prosecution of individuals**
- **Industry-wide investigations**
- **Charitable and political contributions**
- **Transactional due diligence leading to voluntary self-reporting before deal closes**
- **Focus on “disgorgement” of profits**
- **Court-ordered consultants**

International Accounting Principles

- **U.S. based issuers are currently required to file financial statements in conformity with U.S. Generally Accepted Accounting Principles (GAAP)**
- **Many foreign issuers in over 100 countries are either permitted or required to report financial results using International Financial Reporting Standards (IFRS)**
- **In August 2008, the SEC adopted a “roadmap” that could lead to U.S. issuers using IFRS by the year 2014**

Multinational Coordination in Criminal Securities Investigations

International Assistance

- **Mutual Legal Assistance Treaty (MLAT)**
- **Informal Assistance**

Effects of Increased Cooperation

- **National Champions v. Parallel Investigation**
- **Sovereignty Principle**
 - Secrecy
 - Privacy
 - Notice
- **Caught Between Competing Legal Regimes**

Mutual Legal Assistance Treaty ("MLAT")

What is an MLAT?

- **Treaty between the U.S. and a foreign nation**
- **Purpose is to allow U.S. authorities to have some mechanism to obtain information to enforce criminal laws**
- **The U.S. has to specify the purpose of investigation**
- **Although other nation must use best efforts to keep contents confidential, as information is gathered, confidentiality breaks down very quickly**
- **MLAT often specifies that only local authority will conduct investigations**

U.S. MLATs

- Anguilla
- Antigua/Barbuda
- Argentina
- Australia
- Austria
- Bahamas
- Belgium
- Belize
- Brazil
- British Virgin Islands
- Canada
- Cayman Islands
- Cyprus
- Czech Republic
- Dominica
- Egypt
- Estonia
- European Union
- Finland
- France
- Germany
- Greece
- Grenada
- Hong Kong
- Hungary
- India
- Ireland
- Israel
- Italy
- Jamaica
- Japan
- Latvia
- Lichtenstein
- Lithuania
- Luxembourg
- Mexico
- Montserrat
- Morocco
- Netherlands
- Nigeria
- Panama
- Philippines
- Poland
- Romania
- Russia
- South Africa
- South Korea
- Spain
- St. Kitts and Nevis
- St. Lucia
- St. Vincent and the Grenadines
- Switzerland
- Thailand
- Trinidad and Tobago
- Turkey
- Turks and Caicos Islands
- Ukraine
- United Kingdom
- Uruguay
- Venezuela

Select Countries with no U.S. MLATs

- Afghanistan
- China
- Indonesia
- Iran
- Iraq
- North Korea
- Pakistan
- Saudi Arabia
- Vietnam
- New Zealand

Switzerland MLAT

- **First MLAT (1977)**
- **Came about as legal differences between Swiss civil law and U.S. common law made international coordination difficult**
- **The Swiss have a much more narrow view of financial crimes than U.S.**
- **Only provides for refusal of assistance in matters that will prejudice Requested State's sovereignty or security, or if the subject of investigation has already been acquitted or convicted in Requested State**

United Kingdom MLAT

- **Assistance is more reaching than under the EU MLAT**
- **Details non-exhaustive list of methods of assistance**
- **Only provides for refusal of assistance in matters that will prejudice Requested State's sovereignty or security, if the subject of investigation has already been acquitted or convicted in Requested State, or if it is an offense of political character**
- **Consultation between states required before assistance is denied**

Informal International Coordination

Informal Methods of Mutual Assistance

- **Memorandum of Understanding (MOU) – non-legally binding written agreements**
- **Mutual Administrative Assistance – requires consent of Requested State**
- **International Police Cooperation – MLAT request is often made based on information received at this level**

Examples of Mutual Assistance

Royal Ahold

- Mutual Assistance between the U.S. and the Netherlands in the investigation of millions of dollars of fictitious “promotional funds” being reported by Royal Ahold subsidiary, U.S. Foodservice, Inc (“USF”)
- Information was passed to the DOJ through MLAT, which resulted in nine indictments in July 2004
- Information was passed to SEC through MOU, which resulted in \$1.1 Billion settlement
- Of nine indictments, all but one plead guilty and received some form of probation
- Mark P. Kaiser, executive of USF, went to trial in October 2006.
- Kaiser was found guilty of security fraud, false filings with SEC, and conspiracy
- Kaiser was fined \$50,000 and sentenced to 84 months in prison

Enron - Natwest Three

- Three British executives from Natwest Bank had business dealings with Enron and Andrew Fastow
- When Fastow was being investigated by SEC, the Natwest Three voluntarily met with the British FSA November 2001
- They told the FSA everything they knew about their dealings with Fastow
- The FSA completed its investigation without taking any action against the Natwest Three
- The FSA passed its results to the SEC and DOJ
- Arrest warrants were issued for Natwest Three in June 2002
- They were indicted by a Houston Grand Jury in September 2002
- They fought extradition in England and lost their final appeal in July 2007
- The Natwest Three entered a guilty plea to one count of wire fraud in November 2007
- Sentenced to thirty-seven months imprisonment and order to repay \$7.3 Million

Questions

Self Study Code: 347511