After Morrison: The Case for a New Hague Convention on The Law Applicable to Securities Frauds

Emmanuel Gaillard*

On 24 June 2010, the United States Supreme Court rendered a decision in the *Morrison v National Australia Bank Ltd* case that has not gone unnoticed outside of the United States as, by definition, it relates more to foreign litigants than to US litigants. The decision firmly rules against foreign-cubed securities class action lawsuits, thus named because, from the point of view of the United States, they are foreign in three respects: they are between non-US plaintiffs and non-US defendants and relate to the quality of stock market information given by a company listed outside of the US.[1]

There is quite a strong temptation for foreign litigants – in practice, for lawyers specialising in representing plaintiffs in class action lawsuits that they themselves have initiated after identifying suspicious movement on a share price – to bring such matters before a US court, despite their obviously being more closely linked to one or more other legal systems. The point is to benefit from the US procedural arsenal, which is intended to create a high level of legal uncertainty in the hope that it will facilitate the settlement of collective disputes that, in this way, find themselves subject to

* Emmanuel Gaillard is Professor of Law, Paris XII University and Managing Partner, Shearman and Sterling, Paris. He represented France in its *amicus curiae* intervention before the United States Supreme Court in the *Morrison* case.

1 On the entire question, see Ph S E Schreiber 'A Rat Res? Questioning the Value of Res Judicata in Rule 23 (b) Superiority Inquiries for Foreign Cubed Class Actions Securities Litigations', 48 *Colum J Transnat'l L* 114, 115 (2009); S J Choi and L J Silberman, 'Transnational Litigation and Global Securities Class-Action Lawsuits', 2009 *Wis L Rev* 465 (2009).

an original form of regulating economic relations.[2] This is in line with the purest liberal tradition since both initiating proceedings and settling them are left largely to the parties, while the role of the judge is, for all practical purposes, limited to merely confirming the settlement that has been reached amicably between the class's lawyers and the defendants. The ingredients of this legal uncertainty or, more precisely, of this uncertainty of the outcome, are the following. The first is naturally the existence of a collective action in which, where a class has the homogeneous characteristics required for it to be 'certified' by the judge, a limited number of class members is meant to represent all those who found themselves in the same situation, unless they expressly opt out of the class so as not to find themselves bound by the result of the litigation. The second relates to the method of remunerating the plaintiffs' lawyers, who are permitted to have their fees depend solely on the outcome of the dispute. Commonly the fees amount to between ten and 30 per cent of the result.[3] In 2009, the total amount of settlements reached in securities class actions was US$3.829 billion. On a conservative basis assuming fees of 15 per cent of the result, this would mean that the amount of fees received that year by class action plaintiffs' lawyers was more than half a billion dollars in securities cases alone.[4] The third, now well known, is that of pre-trial discovery which enables a party, even before having precisely articulated its claims, to demand that the other party give it access to all the documentation, including documents in electronic form, that are likely to relate to the dispute.[5] The fourth, the importance of which cannot be underestimated, is that the risk for the plaintiffs – or rather to the lawyers financing the action – is limited to needlessly incurring their own expenses: they are not at risk of having to repay the costs and expenses incurred by their opponents in their defence. Indeed, US judges will not order the losing party to bear its opponent's costs, so strong is the idea that this is the price of making access to the courts a real and not merely a formal right. The fifth, which alone creates a maximum of uncertainty is that these trials, however technical their nature may be, are decided by a jury, the members of which are drawn at random from the population, as the right

2 On uncertainty of the law as a driving force for the regulation of commercial relations in the US, see eg A Garapon and I Papadopoulos, *Juger en Amérique et en France, Culture juridique française et common law,* (Odile Jacob, 2003).

3 As a basis for comparison, in the *Enron* case, the plaintiffs' lawyers deducted an amount of US$688 million from a settlement of US$7.2 billion reached in 2008.

4 US$574 million on the basis of an estimate of 15 per cent. On the question, see eg E M Ryan and L E Simmons, 'Securities Class Action Settlements' 2009, *Review and Analysis* (2010).

5 On the delights of e-discovery, see eg E Burns, M Greer Galloway, J Gross, 'E-Discovery: one year of the amended Federal Rules of Civil Procedure' 64 NYU *Ann Surv Am* L 201 (2008-2009).

to be judged by a 'jury of one's peers' is written into the US Constitution.[6] Even though the idea of being judged by a 'jury of one's peers' may be somewhat baffling for a French party appearing, in a commercial matter, before a jury in Harris County, Texas, US law is very attached to jury trials, which it considers as a guarantee of democratic and fair justice. In this context, the possibility that a defendant might be ordered to pay punitive damages that far exceed the amount of the loss actually suffered, which, in securities matters, exists only in the law of the federated States but not in federal law, appears almost as a secondary concern.[7]

The US is the only country in the world to combine these various elements. This should be sufficient to dispel the myth that, in contemporary comparative law, the fundamental divide is still between common law countries and countries with a civil law tradition. In particular, with a few exceptions, civil trials conducted under English law have neither juries nor result-based fees and English courts generally order the losing party to pay the costs and expenses that it needlessly forced its successful opponents to incur (ie costs follow the event). This goes to show that it does not share the American ideology of judicial uncertainty as a factor in the private settlement of collective commercial relations.

Foreign litigants – or their self-appointed lawyers – therefore have every reason to try their luck before US courts, even if the US legal system does not seem to be the most closely connected to the dispute. As we discuss, this temptation will survive the *Morrison* decision, which will eventually make addressing this issue on the international level indispensable. This is what I propose to show (III) after having reviewed the content of the *Morrison* decision (I) and its foreseeable consequences (II).

The *Morrison* case

One could not imagine a clearer example of foreign-cubed class actions than the *Morrison* case. In this case, three Australian shareholders sued in the US an Australian bank, National Australia Bank Ltd, which is listed in Australia and on various other stock markets (New Zealand, Tokyo and London), but not in the US. The claim alleged securities fraud on the ground that the bank had incorrectly informed the public of the way in which the bank's US subsidiary calculated the current value of its

6 7th Amendment concerning civil trials before the federal courts.

7 Punitive damages have been deemed contrary to international public policy in some countries with a civil law tradition. See eg in Japan, *Oregon Partnership Northcon I v Mansei Kogvo KK et al*, 51 Minshu 2573 (Supreme Court, 11 July 1997) 41 *Japanese Yearbook of International Law* (1998), 104.

future profits. Of course, there were US holders of American Depository Receipts (ADRs), including Morrison, the fourth plaintiff, but the judges had no difficulty in noting that he had actually pled no loss resulting from allegedly incorrect information.[8] We could therefore not have imagined a clearer situation in which, in relation to the US, everything was foreign: the plaintiffs, the defendant and the disputed activities.

The claim in this case was so obviously unjustified that there was no doubt as to its disposal. However, considerable importance attached to the choice of the criterion on the basis of which it would be dismissed. Indeed it was to establish a precedent in the face of a split between the federal courts of appeals of different circuits that the Supreme Court, in accordance with its role, accepted to hear the case. Before the Supreme Court, the real debate was therefore between, on the one hand, the US Securities and Exchange Commission (SEC), whose position was supported by the United States of America acting in the capacity of *amicus curiae*, and, on the other hand, the other sovereign countries (Australia, but also France and the United Kingdom) which also chose to intervene in the proceedings as *amici curiae*, alongside a number of professional associations which also participated as *amici curiae*.[9] All these protagonists were requesting that the claim be rejected, but the reasons for rejection were diametrically opposed. The defendant itself took no risk: at the time of its oral arguments, it gave up some of its speaking time to the United States, which generally took a position in principle quite unfavourable to defendants in class actions, while acknowledging that, in this case, the plaintiffs' claim should be dismissed. Indeed, the US argued in favour of adopting the very broad criterion that the SEC wanted: American securities legislation would apply where the alleged fraud supposedly had effects in the US or 'significant conduct material to the fraud's success' could be found to have taken place in the US. This criterion was even broader than that applied by the Second Circuit Court of Appeals in *Morrison*, according to which the alleged fraud's centre of gravity had to be located in the US or the alleged fraud had to have effects on US territory. The other sovereign countries that participated insisted that international comity – in modern language, respect for foreign sovereignty – should encourage the US to let them govern situations that are more closely linked to their legal systems according to their court standards. They insisted, as did banking and industry representatives, on the need to adopt a clear criterion or bright-line test whose application does not

---

8 Jure National Australian Bank Sec Litig 2006 US Dist Lexis 94162 at 26-27.

9 The majority opinion was written by Justice Antonin Scalia. It is accompanied by converging but separate opinions by Justices Stephen Breyer, John Paul Stevens and Ruth Bader Ginsburg, who introduced some nuances in the argument.

presuppose significant factual investigations. Indeed, such investigations systematically give rise to significant requests for production of documents that involve considerable costs, such that even when the defendant prevails, its getting bogged down in proceedings before the US courts does not leave it unscathed. Only a clear, easy to apply criterion satisfies the imperatives of legal certainty and predictability. It is this latter course that, strikingly, prevailed in the decision of 24 June 2010. The Court's opinion constitutes a real vindication of the need for legal certainty and of respect for foreign sovereignty. After having corrected the position of the Second Circuit Court of Appeals, which viewed the dispute as an issue of jurisdiction of the courts, whereas we are actually concerned with an issue of the territorial reach of US law, the Supreme Court recalls the inference according to which a law that has not been expressly declared to be extraterritorial by Congress is supposed not to have such an effect. After noting the need for predictable outcomes, the Court then presents a simple criterion that it notes can be described as a bright-line test: US law only applies to 'transactions in securities listed on a domestic exchange' and to 'purchases and sales of securities in the United States'.[10] The criterion considers the transaction that occurred and not the alleged fraud.[11] In terms of legal certainty and predictability of outcome, as in terms of judicial economy and respect for the sovereignty of States, one could not hope for a clearer result.

The foreseeable consequences of the *Morrison* case

The *Morrison* decision has moved the debate from judicial terrain onto legislative terrain and thus requires plaintiffs' lawyers in securities class actions to revise their litigation strategies.

The legislative debate

The setback suffered by the SEC before the US Supreme Court has not put an end to its ambition to hear and, as necessary, penalise under US law, possible securities fraud relating to companies listed outside of the US, which a single factor connects to the US. Actually, in the history of American case law, we have never seen a more prompt legislative reaction. The day after the *Morrison* decision was rendered, a provision was added to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 bill, which was intended to restore the SEC's power to penalise fraud under US law where a factual ingredient may have taken place within the US or that would have an effect within the US. Under the eloquent title of

10 Decision, p 24.

11 The criterion used is characterised by the Court itself as a 'transactional test', decision, p 21.

'Extraterritorial jurisdiction', a new paragraph supplementing the current § 22 of the Exchange Act provides:

> 'The district courts of the United States and the United States courts of any Territory shall have jurisdiction of an action or proceeding brought or instituted by the Commission or the United States alleging a violation of section 17(a) involving (1) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors; or (2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States.'

In substance this is the former criterion of the factual ingredient or effects that was used by case law prior to the *Morrison* decision. It is important to observe that this step is not contrary to the Supreme Court's decision. In fact, the Supreme Court bases its entire reasoning on the fact that extraterritoriality is not presumed: it must result expressly from the will of the legislature. As the wording of the Wall Street Reform and Consumer Protection Act was adopted by the House of Representatives on 30 June 2010, by the Senate on 15 July 2010 and the law was signed by President Obama on 21 July 2010, the date of its entry into force, such will cannot be clearer.

This is not, however, the main issue at stake since this text only refers, as matters stand, to civil and criminal actions brought by the SEC or Department of Justice. In relation to private actions brought on the basis of US legislation, the text invites the SEC, according to a method often used by the European Union, to issue a report, within a period of 18 months from the law's adoption, on the appropriateness of bringing a private action that is also extraterritorial. The text invites the SEC to reflect on what the scope of application of such a right should be, including whether it should be limited to institutional investors and whether a more restrictive jurisdictional criterion than that governing the SEC's actions must be used. It specifies that, in its analysis, the SEC must take into account the consequences of adopting such a rule in terms of international comity and analyse on a cost-benefits basis such a possible extension of the SEC's extraterritorial jurisdiction in cases alleging securities fraud. Needless to say, lobbying promises to be intense, including by the very powerful interest group of class action plaintiffs' lawyers, who participate heavily in financing electoral campaigns in the US. For their part, countries that would like to leave room for their own law and their own judges to regulate securities fraud would be wrong to let up their amicable diplomatic pressure on their US partner. The Wall Street Reform and Consumer Protection Act actually

encourages them to voice their concerns where it mentions the cost that adoption by the US legislature of an especially broad extraterritorial jurisdiction criterion could have in diplomatic terms.

New litigation strategies

Independent of any legislative consideration, as matters stand, plaintiffs' lawyers in securities class action lawsuits in the US will be incentivised to revise their litigation strategies to take the *Morrison* decision into account. Detailed analysis of the decision's impact on cases in which a company listed in the US is sued by plaintiffs who, at least in part, did not acquire their securities in the US (as in the *Vivendi* case), falls far outside the scope of this study. One may speculate, however, as to the foreseeable development of actions based, in whole or in part, on the application of foreign securities laws before American courts. As we have observed, the plaintiffs' interest has less to do with the application of US law to govern the merits of the dispute than with access to the procedural arsenal that conducting litigation in the US affords. These aspects are governed by the law of the forum which applies to procedural issues, whatever the law applicable to the merits of the dispute may be. In other words, a trial with discovery, result-based fees and a jury is in no way incompatible with the application of French law or Australian law, for example, to the merits of the dispute. It is therefore safe to assume that a future generation of securities class actions will attempt to take advantage of the broad jurisdiction of US courts, essentially based on the fact of the defendant's doing business in the US,[12] to invite the American judge (and jury) to penalise, at least for one class of investors, failure to comply with the substantive provisions of foreign securities laws. The fact that, in the tradition of the *Arbaugh* and *Union Pacific* decisions,[13] the Supreme Court in the *Morrison* case has criticised the Second Circuit Court of Appeals for having reasoned its decision in terms of the court's jurisdiction and not of applicable law paves the way for this kind of argument. For the United States Supreme Court, the only question at issue was that of the extraterritorial or non-extraterritorial application of US securities legislation.[14] The task for plaintiffs interested in having the alleged violation of a foreign law penalised in the US will nonetheless still be far trickier, since it will be necessary not only to prove the content of the

---

12 On the entire question, see eg B Audit, 'Le droit international privé en quête d'universalité', *Recueil des Cours de l'Académie de Droit International de la Haye* (RCDAI), 305, (2003), esp no 422 *et seq.*

13 *Union Pacific R Co v Locomotive Engineers and Trainmen Gen Comm of Adjustment,* Central Region, 558 US (2009) (slip op, at 12); *Arbaugh v Y and H Corp*, 546 US 500, 514 (2006).

14 Decision II, p 4.

foreign law but also and above all to respond to an argument of *forum non conveniens* that the defendants may make. Indeed, it is more natural for a US judge to apply local law and to acknowledge that, almost by definition, it is preferable to let a foreign judge worry about compliance with his or her own law.[15] Naturally, this does not mean that lawyers specialising in class action lawsuits will not try their luck by bringing actions in the US based on one or more foreign laws, especially in circumstances where the laws of several countries, including the US, may potentially be concerned, by advocating the benefit of consolidating all the procedures in a sole venue.

The indispensable organisation of this issue on an international level

More than any other subject, collective litigation arising from questions of compliance with securities regulations calls for an organisational effort on an international level. The reasons for this necessary organisation are obvious. Listed companies are generally listed on one or more markets that they have chosen. Their shares, however, can be acquired by persons domiciled all over the world. An organised secondary market, such as the ADR programmes in the US, can exist with or without the consent of the issuer. Above all, information given by the company on all the events likely to be of interest to its current or potential shareholders today is worldwide in scope. Securities litigation is concerned precisely with the quality of the information given to the market. At first glance, law using as a connecting factor the actual or potential effect of the criticised information – or lack of information – on its market does not seem unreasonable; such a law would be applicable to any information, wherever it may have been released. In other words, every law in the world has some legitimacy to regulate all alleged securities contraventions. One could not imagine a situation more propitious to forum-shopping and in which an international organisational effort would be more welcome.

One can argue whether such an effort should encompass issues pertaining to jurisdiction or be confined to the issue of applicable law, it being understood that criminal aspects of the matter would realistically be beyond the scope of any international instrument on the matter in any event. In spite of the impact that uniform rules on jurisdiction would have in securities cases, a less ambitious instrument relating to the law applicable to the civil aspects of securities frauds would, at least initially, have a better chance of success. The most effective instrument for

15 On this issue, see eg C Chalas, *L'exercice discrétionnaire de la compétence juridictionnelle en droit international privé*, PUAM, 2001.

advancing a significant effort to harmonise this matter would obviously be an international convention with universal reach, and the Hague Conference on Private International Law appears to be the international organisation best placed to handle such a subject. This subject has all the characteristics of subjects successfully dealt with by the Hague Conference, including the essential one of being sufficiently limited in scope to cover litigation situations, the identification of which is easy to imagine. If they decided to put the issue of the law applicable to the civil aspects of securities frauds on the agenda of the Conference's future work, the Member States would be doing listed companies and the market a big favour in terms of promoting predictability of outcome. By the glowing tribute that it pays to values that are important to the continental tradition, the *Morrison* decision creates a climate that has never been more favourable to negotiating such an instrument. States would be well advised to seize the opportunity for this before the American legislature, under pressure from powerful interest groups, gives in to the temptation to unilaterally regulate the issue in the most extraterritorial way possible.