



Letter from America

Summer 2010

WELCOME

We are pleased to offer this installment of Letter from America in a regular alert to you from our US Litigation and Regulatory practice which takes an in-depth look at legal issues that may impact your business in Europe and internationally.

This issue focuses on the long arm of US jurisdiction.

→ "Foreign-Cubed" Jurisdiction

Richard Hans, the Chair of our New York Litigation Practice Group, and John J Clarke, Jr a New York litigation partner, report on *Morrison v National Australia Bank*, a closely watched case in which the Supreme Court will now consider whether to extend the extraterritorial jurisdiction of US federal securities laws to claims by foreign investors in foreign corporations on overseas exchanges where alleged securities fraud occurred outside the United States.

→ FCPA

In a piece by New York senior associate, Kiera Gans, we learn of recent developments which raise the stakes for enforcement of the Foreign Corrupt Practice Act through a proposed whistleblower "bounty" program now being considered in Congress for "whistle blowers" in such cases.

→ Attachment of Foreign Bank Accounts

Finally, senior New York associate, J P Duffy, writes of a recent matter in which he successfully defended an attempt to attach property located outside the physical boundaries of New York state.

US Securities Laws and "Foreign-Cubed" Jurisdiction

By Richard Hans and John Clarke, Jr

Clients with US and overseas operations who have listings on exchanges outside of the United States anxiously await the US Supreme Court's decision in *Morrison v National Australia Bank* ("NAB case"). It is the latest test of whether and to what extent the jurisdiction and remedies available under US securities laws extend over publicly-held corporations based outside of the United States for conduct occurring outside the United States. The decision is all the more relevant given that the United States presents an attractive venue for securities lawsuits because of the availability of class actions, the possibility of a jury trial and the absence of "loser pays" rules that apply elsewhere.

Globalisation of the capital markets has contributed to a rapid rise in the number of securities class actions brought against non-US corporations. These lawsuits have often been commenced by international investors who purchased shares of overseas companies on exchanges outside of the United States – and are known as "foreign-cubed."

The various circuits of the federal courts of appeal are split over how to view such claims. Several appellate courts consider whether the defendant engaged in fraudulent conduct within the U.S., and if so, whether such conduct was more than merely preparatory to the alleged securities fraud and directly caused the alleged losses. Several others look only to whether the defendant's conduct had a "substantial adverse effect" within the United States. The application of these tests are not mutually exclusive and at least one Court, the US Court of Appeals for the Second Circuit, sitting in New York, has employed a mixture of the two approaches to gain a "better picture of whether there is sufficient US involvement to justify the exercise of jurisdiction by an American court." Under that court's formulation, it is not enough that a non-US corporation does business here; rather, all or some of the alleged fraudulent conduct, must have occurred within the United States.

The facts underlying the *NAB* case pre date the recent subprime and credit market crisis. National Australia Bank ("NAB") is Australia's largest bank and its shares are traded in New York as well as on other exchanges internationally. In 1988, NAB acquired a large Florida-based mortgage service provider, Homeside Lending Inc. During 2001 announced various write-downs arising from over calculations of its mortgage servicing rights which lead to falls in the value of its New York traded shares.

Four individuals who had purchased NAB shares and/or ADRs then sued NAB, Homeside and the individual officers and directors in the US District Court for the Southern District of New York. Three of the four plaintiffs purchased their shares on exchanges outside the United States and sought to represent a class of non-American purchasers of NAB common shares. The fourth plaintiff purchased ADRs and sought to represent a class of American purchasers. The Defendants moved to dismiss the claims of the non-US plaintiffs for lack of jurisdiction and those of the domestic plaintiff for failure to allege he suffered damages springing from the fraud. The District Court dismissed all of the claims, and the non-US plaintiffs took an appeal.

Following its earlier decisions in determining whether to exercise extraterritorial jurisdiction under the federal securities laws, the US Court of Appeals for the Second Circuit, in giving judgment against NAB first looked to "whether the harm was perpetrated here in the US and, if so, whether it affected the domestic markets and investors." As well, the Court found that, notwithstanding Homeside's alleged manipulation of the numbers in Florida, the "actions taken and not taken by NAB in Australia" – overseeing affiliate operations and then reporting the allegedly false and misleading statements in its public disclosures – "were significantly more central to the fraud and more directly responsible for the harm to the investors than" Homeside's alleged manipulation. Because the federal securities laws punish inaccuracy in the statements to the public and investors, not the conduct which underlies the information being disclosed, ensuring the accuracy of any disclosure is central to the responsibilities of the parent company, which in this case was based in Australia. But importantly, Homeside did not communicate directly with NAB's investors or otherwise disclose the alleged manipulated numbers to the public at large.

On appeal, the court was reluctant to allow the defendants to pursue NAB and expressed concern that such cases be brought in the appropriate forum. NAB's counsel argued that allowing "foreign-cubed" cases to be brought in the United States amounted to a form of "legal imperialism" that the Supreme Court has rejected in the past but will re-consider at the end of June.

The Supreme Court will provide some much needed clarification regarding the scope, and perhaps limits on, extraterritorial application of US securities laws. The forthcoming judgment will have far-reaching and potentially explosive effects as it may deter foreign investment in the US for fear of being hauled into court by a class of investors and face enormous potential liability for conduct performed outside the United States. Parent companies should therefore be aware that any statements involving its group business could impact on the liability of subsidiaries which are based in other jurisdictions.

Whistle-Blower legislation: does this raise the stakes for FCPA enforcement?

By Kiera Gans

Recently proposed legislation could establish a new program that could provide the SEC with yet more resources in its efforts to investigate securities violations which could impact on US and international business alike. A bill recently introduced into US Senate, would allow whistle-blowers who report securities violations to recover a percentage of any settlement or sanction. A similar bill has been introduced in the US House of Representatives.

Under the Senate bill, a whistle-blower who provides original information leading to civil enforcement or criminal prosecution would be guaranteed to receive at least 10 percent of a sanction and could stand to receive up to 30 percent, so long as the sanction collected exceeded USD 1 million. The House bill includes the USD 1 million minimum, and the 30 percent cap, but would not guarantee a payout. The SEC would determine the amount of the reward based on various criteria, including the significance of the information and the level of cooperation provided by the individual. The proposed provisions also extend the reward to actions taken by other prosecuting agencies, including, the US Department of Justice or foreign regulators, based on the reported information.

It is still unclear just how strong an incentive this program could provide for employees who have information concerning potential violations of the FCPA. The provisions may have limited impact based on current regulations implemented in 1998 that reward whistle-blowers who come forward in connection with insider trading cases which have rarely been used.

Nevertheless, given that the monetary sanctions associated with financial fraud cases, and in particular FCPA prosecutions, far exceed those of traditional insider-trading cases, it is possible that the program could offer lucrative incentives that would influence the behavior of potential whistle-blowers.

It would appear likely that the Senate bill if enacted could lead to a significant increase in the number of FCPA investigations - and may represent a further incentive for companies to ensure that FCPA compliance regimes are well embedded. It may also present another potentially powerful tool to US regulators by giving incentives for voluntarily disclosure or as a means of encouraging investigation within the ranks.

New York State Court affirms that New York courts cannot attach foreign bank accounts

By JP Duffy

In a matter being handled by DLA Piper's New York office, a New York State court recently clarified the jurisdictional boundaries of attachment proceedings in New York and affirmed that parties cannot employ the New York branch of a bank to attach assets held in that bank around the globe. The ruling is significant because it limits the reach of a recent decision from New York State's highest court in *Hotel 71 Mezz Lender LLC v Falor*, No. 9, 2010 NY Slip Op 1348 (NY 16 February 2010) ("*Hotel 71*") which strongly suggested that New York now permits attachment of foreign bank accounts and that New York courts may issue attachment orders that are akin to freezing injunctions.

Background

In August of last year, DLA Piper was retained by a publicly traded Indian company called Prithvi Information Solutions Limited ("Prithvi") to defend it in attachment proceedings that were commenced in New York by a Japanese company called Sojitz Corporation ("Sojitz"). Sojitz obtained an *ex parte* order of attachment for \$40 million as security for a future arbitral award Sojitz was seeking in an LCIA arbitration seated in Singapore.

After receiving notice of the attachment and appearing on Prithvi's behalf, DLA Piper successfully vacated the \$40 million attachment order on jurisdictional grounds by arguing that the New York State court lacked jurisdiction over both Prithvi (as residing within the state and on property owned by it within the state) and therefore had no grounds for its award. The court accepted both arguments and crafted a new form of pre-award personal jurisdiction when the attachment is sought for "security only," which left Sojitz with a basis for seeking future attachment orders.

How do the US Courts approach attachment proceedings?

In the US's two-tiered state and federal legal system, attachment proceedings are governed by the laws of the state where the attachment is sought. Due to territorial restraints placed on each US state's jurisdiction, an award can only be made when tangible property (such as land) and intangible property (debts) is located within the boundaries of a state.

Impact of Hotel 71

The Prithvi judgment comes hot foot from a recent New York Court of Appeals ruling that overruled the New York state court's previous approach. Handed down in February 2010, the *Hotel 71* decision concerned proceedings brought against defendants from outside New York state to attach intangible property which was also outside of the state. Controversially the court allowed the attachment on the grounds that it was able to seize jurisdiction over the defendant.

The *Hotel 71* decision immediately sent shockwaves through New York legal practitioners, because the decision suggested at first blush that if a debtor (and not necessarily a defendant) was subject to New York jurisdiction, then an attachment could be made to any intangible property that debtor held for a defendant in a New York court proceeding, regardless of where that property was located.

This approach would clearly impact on the global banking system as banks which are debtors to their depositors, are frequent recipients of attachment orders, and most global banks maintain a physical presence in New York.

The Prithvi judgment prohibits attachment of out-of-state bank accounts

Seizing upon the *Hotel 71* decision, Sojitz immediately moved to attach bank accounts located in Pittsburgh, Pennsylvania that were owned by Prithvi. Sojitz predictably argued that even though the bank accounts in question were located outside of New York State, the bank had a branch in New York (over which the court

had jurisdiction), and the accounts were therefore subject to attachment.

Prithvi successfully opposed that attachment request by arguing that the *Hotel 71* decision did not change the longstanding New York rule prohibiting the attachment of out-of-state bank accounts when the defendant, as opposed to the debtor-bank, was impervious to the court's general *in personam* personal jurisdiction. Prithvi successfully demonstrated the serious impact that any other interpretation of *Hotel 71* would have on the global banking system and the systemic damage the proposed attachment would cause to New York as a global banking center.

The court fully accepted Prithvi's arguments and ruled that a New York state court cannot attach bank accounts that reside outside of New York, even if the bank that holds those accounts has a New York branch. By reaching that conclusion, the court reaffirmed the territorial limits of a New York state court's attachment powers and preserved the longstanding New York rule that bank accounts must be held in New York for the accounts to be subject to attachment.

Conclusion

The full scope of the *Hotel 71* decision has yet to be tested, but authority now exists that limits *Hotel 71* when foreign bank accounts are at issue.

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