ARNOLD & PORTER LLP

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THE ELEVENTH CIRCUIT FINDS SUBJECT MATTER JURISDICTION IN "FOREIGN-CUBED" SECURITIES LAWSUIT

In *In Re: CP Ships Ltd. Securities Litigation*, the US Court of Appeals for the Eleventh Circuit issued a decision addressing the issue of the extraterritorial reach of the US securities laws.[1] The Eleventh Circuit found that the US district court properly exercised subject matter jurisdiction over securities fraud claims brought by foreign investors against CP Ships, a Canadian company that was headquartered in England.

The Eleventh Circuit's decision in *CP Ships* follows on the decision of the US Court of Appeals for the Second Circuit in *Morrison* v. *National Australia Bank*,[2] which was the subject of an earlier advisory by Arnold & Porter LLP.[3] The Morrison decision had involved a so-called "foreign-cubed" securities transaction—a transaction where (1) a foreign plaintiff is suing; (2) a foreign issuer in a US court for violations of US securities laws based on securities transactions; in (3) foreign countries. While the Second Circuit affirmed the district court's dismissal of Morrison's suit for lack of subject matter jurisdiction, concluding that the "heart of the fraud" lay outside of the United States, the Court refused to adopt a bright-line rule that barred these types of cases. The *Morrison* case has since been appealed to the Supreme Court of the United States. In June 2009, the Solicitor General was invited to file a brief in that case expressing the views of the United States. It is expected that this brief will be filed shortly.

In *CP Ships*, the Eleventh Circuit found the Second Circuit's decision in *Morrison* to be distinguishable. Although CP Ships is a Canadian company headquartered in England, the complaint alleged that an accounting consolidation of CP Ships businesses was being run by key CP Ships executives out of its Florida office. It was alleged that this consolidation knowingly caused costs to be understated. Executives in the Florida office were alleged to have transmitted the false data to CP Ships foreign offices, where it was incorporated into false and misleading financial statements that were disseminated from abroad.

The Eleventh Circuit stated that, when a court is confronted with a transaction that is predominantly foreign, it should determine whether Congress would have wanted the resources of US courts and law enforcement agencies to be used on it, rather than leaving the problem to foreign countries. In making this determination, the Eleventh Circuit reviewed the "conduct test" and the "effects test." Under these tests,

1 *In Re: CP Ships Ltd. Securities Litigation,* No. 08-16334 (11th Cir. August 13, 2009).
2 *Morrison* v. *National Australia Bank Ltd.*, 547 F.3d 167 (2d Cir. 2008).
3 *Available at:* http://www.arnoldporter.com/resources/documents/CA_SecondCircuitRejectsBarOnForeign-CubedSecuritiesLawsuits_102908.pdf.

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a court asks (1) whether the wrongful conduct occurred in the United States; and (2) whether the wrongful conduct had a substantial effect in the United States or upon US citizens. Jurisdiction exists under the "conduct test" when "substantial acts in furtherance of the fraud were committed within the United States." This test is met when a defendant's activities in the United States are "more than merely preparatory to a securities fraud conducted elsewhere" and the "the activities or culpable failures to act within the United States directly caused the claimed losses." The Court concluded that, because the complaint alleged ample facts sufficient to establish subject matter jurisdiction under the conduct test, it did not need to address the effects test.

The Eleventh Circuit reasoned that the conduct test was satisfied because the manipulation and falsification of the accounting data occurred in the United States and the executives with responsibility for ensuring the accuracy of the accounting data operated from the United States as well. The court distinguished these facts from the facts of *Morrison*, in which the manipulation of the data occurred in the United States, but the executives bearing responsibility to present accurate information to the investment public and their actions in supervising and verifying such information were located in Australia. In contrast to *Morrison*, the Eleventh Circuit determined that, in *CP Ships*, there was no "lengthy chain of causation" between the United States' contribution to the misstatements and the harm to investors, noting that the "causation was direct and immediate."

As evidenced by the decisions in the Second and Eleventh Circuits, jurisdictional issues that arise in transnational securities fraud cases are very fact specific and will be decided on a case-by-case basis. However, these decisions provide a roadmap for other courts to follow when faced with questions regarding the extraterritorial application of the US securities laws. Until the Supreme Court of the United States rules on this issue, foreign issuers, dealers, and other parties should take these decisions into consideration when determining how to participate in transnational activities.

We hope that you had found this advisory useful. If you have additional questions, please contact your Arnold & Porter attorney or:

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