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Challenges in Securities Litigation Involving Foreign-Based Issuers

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Despite its widespread attention, *Morrison v. National Australia Bank NA*, 130 S.Ct. 2869 (2010), does not foreclose securities litigation in the United States against foreign-based companies whose stock trades in this country. Federal courts remain open to those shareholders seeking redress for alleged fraud. As the Supreme Court stated, section 10(b) of the 1934 Securities Exchange Act applies to ''transactions in securities listed on domestic exchanges.'' *Id.* at 2884. Even so, securities suits raising claims against foreign-based issuers still present special litigation challenges.

Personal Jurisdiction

These challenges can arise at any point in the litigation. At the start is the problem of personal jurisdiction and service of process for foreign-based defendants. A plaintiff must independently establish personal jurisdiction as to each defendant. *See In re Alstom SA Sec. Litig.*, 406 F. Supp. 2d 346, 397 (S.D.N.Y. 2005). Even if the foreign corporate entity is found to have sufficient minimum contacts to establish jurisdiction, a separate analysis must be conducted for each individual defendant. A party's status as a director or officer of a U.S.-traded company, for example, does not in itself create personal jurisdiction. *Id.* at 399.

Courts examine the particular acts of the defendant to assess whether jurisdiction lies. Conduct outside of the jurisdiction that has a direct and foreseeable effect within it may create personal jurisdiction. *See, e.g., TCS Capital Mgmt., LLC v. Apax Partners, L.P.*, 2008 U.S. Dist. LEXIS 19854, at *29-33. (S.D.N.Y. Mar. 7, 2008) (finding jurisdiction where it was ''foreseeable'' that statements in SEC filings ''might have an effect'' on company's stock price). Signing a registration statement or other SEC-filed document or having responsibility for (even if not making) statements disseminated in the United States may be sufficient. *See In re Alstom*, 406 F. Supp. 2d at 399-401; *see also, e.g., TCS Capital Mgmt.*, 2008 U.S. Dist. LEXIS 19854, at *29-33 (defendants prepared and approved allegedly false document appended to SEC filing); *In re Royal Ahold N.V. Sec. & ERISA Litig.*, 351 F. Supp. 2d 334, 351-352 (D. Md. 2004) (''United States courts frequently have asserted personal jurisdiction over individual defendants who sign or, as control persons, approve the filing or disseminating of, particular forms required by the SEC which they knew or should have known would be relied on by U.S. investors'').

On the other hand, those acts may not be sufficient to establish jurisdiction. *See, e.g., In re AstraZeneca Sec. Litig.*, 559 F. Supp. 2d 453, 467 (S.D.N.Y. 2008) (signing the F-3, an SEC filing incorporated into company's allegedly false 20-F, ''insufficient for personal jurisdiction''); *Tracinda Crop. v. DaimlerChrysler AG*, 364 F. Supp. 2d 362, 390-391 (D. Del. 2005) (declining to

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exercise jurisdiction where claims not predicated on Registration Statement signed by defendant).

As in any personal jurisdiction analysis, the court will examine the totality of circumstances to determine if the defendant has sufficient minimum contacts to establish personal jurisdiction. *See, e.g., J. McIntyre Machinery LTC v. Nicastro*, 131 S.Ct. 2780 (2011).

Service

Even if the court has personal jurisdiction, there is still the issue of serving the foreign defendant. For foreign-based individuals, plaintiffs must comply with either the Hague Convention on Service Abroad of Judicial and Extrajudicial Documents in Civil or Commercial Matters or the Additional Protocol to the Inter-American Convention on Letters Rogatory,[1] which can be cumbersome, expensive and lengthy processes requiring the involvement of foreign authorities. Under the Hague Convention, for example, the United States court must transmit the documents to be served to the ''Central Authority'' (as specified by local law) of the foreign country where the service is to occur.[2] The Central Authority executes the request for service or causes it to be executed by (i) informal delivery to the defendant, who accepts it voluntarily; (ii) a method provided by local foreign law; or (iii) a particular method requested by the plaintiff, unless that method is incompatible with the law of the foreign country. *Id*. The Central Authority may also request a translation of the documents to be served, *id*. at 2, which, given the length of the typical securities class action complaint, can be a burdensome and costly exercise.

Discovery

Perhaps most complex may be the challenges parties face in obtaining discovery overseas. At the outset, parties may be required to tackle a basic translation issue, both with documents and testimony, that can add substantial time and expense. On top of that issue are the legal restrictions imposed by some foreign countries on the collection of information. In contrast to the general U.S. policy of relatively broad, party-conducted discovery in civil litigation, many foreign countries have blocking statutes and strict privacy and other laws that may impact the ability of a party to gather and use information, whether it is in the possession of opposing or third parties.

Blocking Statutes

Foreign courts have historically been wary of U.S. discovery rules, particularly in civil law countries where the investigatory process is often controlled by court officials rather than the parties. *See, e.g., In re Perrier Bottled Water Litig.*, 138 F.R.D. 348, 355 (D. Conn. 1991). Blocking statues, which are found in Australia, France, Germany, the United Kingdom, and many other countries, prohibit or restrict the transfer of information requested in the course of foreign (*i.e.*. U.S.) legal proceedings.[3] By way of example, the French blocking statue provides that ''[s]ubject to treaties or international agreements and applicable laws and regulations, it is prohibited for any party to request, seek or disclose, in writing, orally or otherwise, economic, commercial, industrial, financial or technical documents or information leading to the constitution of evidence with a view to foreign judicial or administrative proceedings or in connection therewith.'' French Penal Code Law No. 80-538 Art. 1A. Depending on the country, violation of a blocking statute can be a criminal and not merely a civil offense. *See* Cour de Cassation Chambre Criminelle, Paris, Dec. 12, 2007, Juris-Data no. 2007-332254 (French lawyer fined €10,000 in criminal proceeding for attempting to obtain discovery in France for a U.S.-based litigation).

In the face of a blocking statute, the party seeking discovery generally will need to resort to the Hague Convention procedures, which require letters rogatory to request a central authority or local court to allow for the taking of evidence and obtaining information abroad.[4] Under the Hague Convention, a foreign country can limit whether and how evidence within its borders may be obtained. For example, depositions taken in France must be taken before a local judicial authority by a written letter rogatory or before a United States diplomatic or consular officer or other person commissioned by the court.[5] If the deposition is taken by letter rogatory (which must be in French), the letter rogatory must include the questions or subject matter to be put to the witness. *Id*. The responses, of course, will be in writing. Live depositions in France may be conducted before those individuals designated by the court, but only if prior authorization has been granted by the French Ministry of Justice, which also must receive all documents pertaining to the case, including a list of the questions or subject matter on which the witness is to be examined, at least 45 days before the deposition. *Id*.

Countries operating under the Hague Convention are permitted to limit (or entirely opt out of) various provi-

[1] *See* Convention of 15 November 1965 on the Service Abroad of Judicial and Extrajudicial Documents in Civil or Commercial Matters, http://www.hcch.net/index_en.php?act=conventions.status&cid=17; Additional Protocol to the Inter American Convention on Letter Rogatory, http://www.oas.org/juridico/english/sigs/b-46.htm.

[2] *See* Outline, Hague Service Convention, http://www.hcch.net/upload/outline14e.pdf, at 1, n.3. (November 2009).

[3] In some circumstances, a party may voluntarily respond to discovery without violating blocking statutes. Any response will still be subject to the limitations discussed *infra*.

[4] *See* Convention of 18 March 1970 on the Taking of Evidence Abroad in Civil or Commercial Matters, http://www.hcch.net/upload/conventions/txt20en.pdf; Inter American Convention on Letter Rogatory, http://www.oas.org/juridico/english/treaties/b-36.html.

[5] *See* Judicial Assistance France, Travel.State.Gov, http://travel.state.gov/law/judicial/judicial_647.html.

sions of that treaty, which means that the applicable terms of the Convention and the extent to which they may be superseded by local law could vary from country to country. *See* Convention On The Taking of Evidence Abroad In Civil Or Commercial Matters, Art. 23 (contracting state may ''declare that it will not execute Letter of Request issued for the purpose of obtaining pre-trial discovery of documents as known in Common Law countries''). Many countries, including China, France, and the United Kingdom, have executed some form of declaration under Article 23.[6]

Privacy Statutes

Many nations also have broad privacy statutes that limit the type of information that may be obtained and removed from the country and the uses to which that information may be put. European Union countries, for example, are subject to particularly rigorous privacy protections under EU Data Protection Directive 95/46/EC, which deems private communications – even those made by an employee about her job using the company's computer and email system – a fundamental human right belonging to the individual. *See, e.g., Nikon France vs. Onof,* Cass. Soc., No. 4164 (Oct. 2, 2001). That regime protects ''personal data,'' which broadly relates to any ''identifiable'' individual – in other words, any information that can be used directly or indirectly to identify an individual.[7] The substantive protections are supported by a variety of process-related rules that govern, for example, providing notice and access to, and obtaining the consent of, the individual whose information is sought; limiting the processing, use, and purpose for which the information is sought; and maintaining the confidentiality and security of the information. *See* EU Directive 95/46/EC Articles 6, 7, 10-11, 12, 16-17.

While specific privacy statues and the extent to which they are enforced will vary by country, at least in Europe they generally require certain guarantees and safeguards before personal data may be exported outside the EU. Even if the information can be obtained, personal data may not be transported to countries without an ''adequate'' level of protection. *See* EU Directive 95/46/EC Article 25. The EU Commission has approved a small number of non-EU countries as safe for export, *see* EU Directive 95/46/EC Article 25(6), but the United States is not one of them. Contractual provisions and protective orders entered by a U.S. court that address limitations on use, dissemination, storage, and control of the information may be sufficient to enable document export in individual cases.

While the EU Directive may permit the export of information where necessary for a party in possession of the information to establish, exercise or defend its legal rights or to comply with a legal obligation, a discovery obligation in a civil case may not be a sufficient basis to provide the information. *See*, *e.g.* EU Directive 95/46/EC Articles 8, 26.

Secrecy Statutes

Foreign secrecy laws also can impact the ability of parties to obtain and provide discovery in U.S. proceedings. Foreign bank secrecy laws have historically been the most familiar of these statutes. *See, e.g.*, Swiss Banking Act of 1934, Article 47 of the Swiss Federal Law of 8 November 1934 on Banks and Savings Banks (limiting information that may be shared with third parties, including foreign governments, except when requested by a Swiss judicial subpoena); Confidential Relationships (Preservation) Law (Law 16 of 1976), as amended (Law 26 of 1979) (Cayman Islands bank-secrecy law) (criminalizing a breach of the duty of confidentiality owed by a bank to its customer, including by providing information to foreign courts, unless prior permission is granted by the judge of the Grand Court of the Cayman Islands). More recently, practitioners are increasingly having to grapple with state secrecy statutes, particularly relating to information located in China.

China's state secrecy laws, which criminalize the disclosure of information that relates to Chinese national security and other potentially sensitive interests, require a party with certain information relating to a Chinese company, including a company incorporated outside of China but with its principal place of business in China, to resist foreign discovery. The law covers a broad range of information, including that relating to national economic and social development, science and technology, and other matters classified as ''secret'' by the government. *See* Law of the People's Republic of China on Guarding State Secrets, Order No. 6 of the President of the People's Republic of China (Sept. 5, 1988). All Chinese companies, including those seeking to list on a foreign exchange, are required first to register various financial and audit information with the Chinese Bureau of Industry and Commerce, and all such documents are classified as ''archive documents'' protected under a related Archive Law of the People's Republic of China. *See* China Securities Regulatory Commission State Secret Bureau State Archives Administration Public Announcement [2009] No. 29, China Securities Regulatory Commission, State Secret Bureau and State Archives Administration (October 20, 2009); *see also* Corporate Registered Archive Information Enquiry Regulations, Arts. 5-7; Corporate Persons Registration Information Regulations, Art. 2; PRC Archives Law, Arts. 2 and 16. Given the number of Chinese companies that have some level of government ownership, control, or interest, the reach of these provisions is potentially quite broad. *See* PRC Archives Law, Arts. 2, 16 and 18 (contracts with the central or a local government, as well as information relating to the creation of the contracts, are ''government archives'' and may not be exported from China).

Discovery in China can be additionally complicated for documents in the possession of China-based auditors because a Chinese public accountancy statute generally prohibits accountants from disclosing information relating to a Chinese company. *See* Law of the People's Republic of China on Certified Public Accountants (October 31, 1993), Art.19. United States regulators are compelled to request auditors' documents from the Chinese Securities Regulatory Authority, the Chinese equivalent of the SEC, but the SEC has had trouble obtaining documents through this procedure. *See* SEC Press Release 2012-87 (May 9, 2012). Private parties in

[6] *See* Convention of 18 March 1970 on the Taking of Evidence Abroad in Civil or Commercial Matters, http://www.hcch.net/index_en.php?act=conventions.status&cid=82 (status table listing the contracting states to the Convention, as well as any relevant declarations made by each individual state).

[7] *See* European Data Protection Supervisor, http://www.edps.europa.eu/EDPSWEB/edps/cache/off/EDPS/Dataprotection.

civil litigation, who must rely upon the Hague Convention and other provisions of Chinese law, can expect to have a tougher go of it.

How Do U.S. Courts Respond?

When foreign laws are implicated in a party's discovery efforts, U.S. Courts are often asked to weigh in, and judges sometimes recognize that foreign discovery laws can complicate domestic litigation. *See, e.g., SEC v. Compania Internacional Financiera S.A.*, No. 11 Civ. 4904-JPO (S.D.N.Y. May 22, 2012) at 1, 4, 12 (Memorandum and Order) (noting impact of foreign banking, data protection, and privacy laws on discovery). Presented with the question of foreign discovery, courts generally undertake a balancing test to determine whether and to what extent a foreign statute may excuse noncompliance with a discovery order. The factors considered include:

- the importance of the information to the litigation;
- the discovery's specificity;
- whether the information originated in the United States;
- the availability of alternative means of securing the information, and;
- the extent to which noncompliance with the discovery would undermine the important interests of the United States, or compliance with the request would undermine important interests of the foreign state where the information is located.

See Richmark Corp. v. Timber Falling Consultants, 959 F.2d 1468, 1475 (9th Cir. 1992) (citing the Restatement (Third) of Foreign Relations Law § 442(1)(c)); *Linde v. Arab Bank PLC*, 269 F.R.D. 186, 195 (E.D.N.Y. 2010) (same); *see also United States v. Vetco Inc.*, 691 F.2d 1281, 1288 (9th Cir. 1981) (also considering the ''extent and the nature of the hardship that inconsistent enforcement would impose upon the person. . .[and] the extent to which enforcement by action of either state can reasonably be excepted to achieve compliance with the rule prescribed by the state'')(quoting the Restatement (Second) of Foreign Relations Law § 40); *General Atomic Co. v. Exxon Nuclear Co.*, 90 F.R.D. 290 (S.D. Cal. 1981) (considering good faith of responding party).

In the seminal case of *Societe Internationale Pour Participations Industrielles et Commerciales, S.A. v. Rogers*, 357 U.S. 197 (1958), a Swiss plaintiff failed to comply with a discovery request on the basis that such compliance would violate Swiss penal and bank secrecy laws. The district court dismissed the plaintiff's complaint as a sanction for noncompliance, but the Supreme Court ultimately reversed. *Id*. The Supreme Court held that Federal Rule of Civil Procedure 37, which addresses discovery sanctions, does not authorize dismissal of the plaintiff's complaint where the failure to comply with discovery is ''due to inability, and not willfulness, bad faith, or any fault of [the plaintiff].'' *Id*. at 1267.

Subsequent courts facing international discovery questions have turned for guidance to *Societe* as well as to section 442 of the Restatement (Third) of Foreign Relations Law of the United States (1987) (previously § 40 of the Restatement (Second) of Foreign Relations Law of the United States (1965)). In *In re Westinghouse Elec. Corp. Uranium Contract Litigation*, 563 F.2d 922 (10th Cir. 1977), the Tenth Circuit Court determined that the party failing to comply with discovery had acted in good faith, pointing particularly to the fact that the party had made diligent efforts to produce materials not subject to foreign regulations (in this case, Canada) and had sought a waiver from the Canadian authorities with regards to the other materials being sought in discovery. *Id*. at 998-99. Similarly, the Court in *Reinsurance Company of Amer., Inc. v. Administratia Asigurarilor de STAT*, 902 F.2d 1275 (7th Cir. 1990), was faced with a party's refusal to respond to interrogatories on the ground that Romanian state secrets and ''service secrets'' laws forbade disclosure of the requested information. *Id*. at 1279. Taking into account the factors set out by the Restatement of Foreign Relations Law, the Court concluded that the lower court had properly determined that discovery should not be compelled in the face of the Romanian law, noting that ''Romania places a high price on [the] secrecy under its protective laws.'' *Id*. at 1281-83. More recently, the Court in *Tiffany (NJ) LLC v. Qi Andrew*, 276 F.R.D. 143 (S.D.N.Y. 2011), agreed with three banks in China that they could not be compelled to produce documents in light of Chinese law prohibiting such disclosure. *Id*. at 150. Again looking to the Restatement of Foreign Relations Law, the Court concluded that plaintiffs must continue to request the information they seek in China through the Hague Convention rather than through Court order, noting ''China's interest in protecting bank custo mers' privacy'' and the ''multitude of civil and criminal regulations [China] has enacted to protect these interests.'' *Id*. at 160.

Enforcing Judgments

Even if successful on the merits, plaintiffs may be confronted with problems trying to collect a judgment from a foreign-based defendant. Some companies even disclose this issue as a risk factor in their public filings.

> **Certain judgments obtained against us by our shareholders may not be enforceable.**
>
> We are a Cayman Islands company and substantially all of our assets are located outside of the United States. Nearly all of our current operations are conducted in China. In addition, most of our directors and officers are nationals and residents of countries other than the United States. A substantial portion of the assets of these persons are located outside the United States. As a result, it may be difficult for you to effect service of process within the United States upon these persons. It may also be difficult for you to enforce in U.S. court judgments obtained in U.S. courts based on the civil liability provisions of the U.S. federal securities laws against us and our officers and directors, none of whom is resident in the United States and the substantial majority of whose assets is located outside of the United States. In addition, there is uncertainty as to whether the courts of the Cayman Islands or China would recognize or enforce judgments of U.S. courts against us or such persons predicated upon the civil liability provisions of the securities laws of the United States or any state. In addition, there is uncertainty as to whether such Cayman Islands or Chinese courts would be competent to hear original actions brought in the Cayman Islands or China against us or such persons predicated upon the securities laws of the United States or any state.
>
> ATA, Inc. June 15, 2011 Form 20-F at 22

To the extent that foreign defendants lack U.S.-based assets against which to collect, it will be necessary to

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enforce the judgment abroad. No treaty or international convention on reciprocal recognition and enforcement of judgments exists between the United States and any other country, so enforcement will be determined by the internal laws of the foreign country. *See* Enforcement of Judgments, Travel.State.Gov. The laws of some nations expressly permit the enforcement of foreign judgments. In China, for example, Article 267 of the PRC Law of Civil Procedure provides that both a party to a judgment and the foreign court that issued it may apply for recognition and enforcement of the judgment. But foreign courts do not automatically enforce U.S. judgments, even if authorized by law to do so, and legal, bureaucratic, and cultural issues may prove an impediment to the ultimate enforcement of a judgment.

Conclusion

Litigation involving a foreign party, whether as plaintiff, defendant, or non-party subject to discovery, can raise additional challenges not involved in purely domestic cases. Parties increasingly may be called upon to know and to navigate competing responsibilities under the different laws of several nations, laws that may be inconsistent if not seemingly incompatible, and to educate and help to guide the U.S. courts through those differences. Given the 720 foreign-based companies that currently trade on NASDAQ, NYSE, and AMEX,[8] when it comes to the challenges posed by foreign law, securities litigators will need to be prepared with more than just their passports.

[8] *See* http://www.nasdaq.com/screening/company-list.aspx.