07-0583-cv

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

ROBERT MORRISON, individually and on behalf of all others similarly situated,
RUSSELL LESLIE OWEN, BRIAN SILVERLOCK,
and GERALDINE SILVERLOCK,

Plaintiffs-Appellants,

MARIA KENNEDY, HARVARD B. KOLM, and NORMAN HAUGE,

Plaintiffs,

-v-

NATIONAL AUSTRALIA BANK LTD., HOMESIDE LENDING INC.,
FRANK CICUTTO, HUGH HARRIS, KEVIN RACE, and W. BLAKE WILSON,

Defendants-Appellees.

On Appeal from the United States District Court
for the Southern District of New York

BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION AS *AMICUS CURIAE*, IN RESPONSE TO THE COURT'S REQUEST

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BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION
AS *AMICUS CURIAE*, IN RESPONSE TO THE COURT'S REQUEST

INTRODUCTION

The Securities and Exchange Commission submits this brief *amicus curiae* in response to the Court's invitation to offer "the views of the [Commission] on both the broader questions posed by this case and the case itself" as to whether

antifraud provisions of the United States securities laws apply to the alleged transnational fraud. This case involves foreign purchasers who bought a foreign issuer's securities on a foreign exchange, but where significant aspects of the fraudulent conduct occurred in the United States.

The Commission believes that this Court should expressly set forth the following standard to assess whether the antifraud provisions apply to transnational securities-fraud cases:

> 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.

That formulation is reflective of the Second Circuit's present approach and it provides an overall conceptual framework to guide lower courts as these confront jurisdictional issues in future transnational securities fraud cases.

This Court's case law can be read to set forth a series of "diverse formulations" of the applicable legal standard. In re Alstom SA Sec. Litig., 406 F. Supp. 2d 346, 373-74 (S.D.N.Y. 2005). For example, in the view of one district court, there has been an "apparent shift in emphasis from a test of strict causation" – one where the domestic conduct must be the immediate cause of the overseas investors' losses – "to one of materiality of the domestic acts." Id. This has

created a “tension” in the case law, id., and, as a result, district courts have largely resorted to engaging in a case-by-case comparison of the specific fact patterns to those of existing Circuit precedent. As the district court here explained, “[t]he complexity of th[is] required analysis means that individual cases are decided on very fine distinctions.” (SPA-9 (2006 WL 3844465) (“This analytical undertaking is complicated by the commercial realities that imbue modern international securities transactions.”)).

The Commission believes that this Court could bring greater clarity to this area by adopting the proposed formulation. Furthermore, because this jurisdictional test would also be applied to Commission actions, see SEC v. Berger, 322 F.3d 187, 193-94 (2d Cir. 2003), we believe that the proposed standard would help preserve the Commission’s ability to bring an enforcement action involving future transnational frauds such as the one alleged in this case.

Finally, the Commission believes that, applying that standard to the allegations in plaintiffs’ complaint, material and substantial conduct in furtherance of the alleged fraud occurred in the United States so as to support application of the antifraud provisions (at least with respect to enforcement actions brought by

the Commission or private actions brought by named foreign plaintiffs). [1]

STATEMENT OF THE ISSUES ADDRESSED

1. Do the antifraud provisions of the securities laws extend 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 part of the alleged fraud ?

2. Do the plaintiffs' allegations satisfy this standard?

BACKGROUND

A. General Background as to the Transnational Reach of the Antifraud Provisions of the Securities Laws.

1. Cases Involving Transnational Securities Frauds Are Becoming More Prevalent and Raise Difficult Questions Concerning the Application of the Antifraud Provisions of the Securities Laws.

This appeal involves the question of whether Congress, in the exercise of its

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[1] This Court has suggested on several occasions, based on additional policy considerations unique to class actions, that a more jurisdictionally restrictive standard may be warranted in the class-action context. See ITT v. Vencap, Ltd., 519 F.2d 1001, 1018 n.31 (2d Cir. 1975); see, e.g., SEC v. Berger, 322 F.3d 187, 195 (2d Cir. 2003); Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 987 (2d Cir. 1975). The Commission does not take a position on what, if any, additional showing should be required for class actions. In this brief, therefore, we are only discussing the application of the conduct test as it would apply to Commission enforcement actions and private suits by named foreign plaintiffs.

legislative or prescriptive jurisdiction, intended the antifraud provisions of the securities laws to apply to securities frauds that take place in part in the United States and in part overseas, but that principally or exclusively result in losses to overseas investors. These types of suits have become more prevalent in recent years. See, e.g., Royal Dutch/Shell Transp. Sec. Litig., 380 F. Supp. 2d 334 (D.N.J. 2005); In re Bayer AG Sec. Litig., 2004 WL 2190357 (S.D.N.Y. Sept. 30, 2004); Froese v. Staff, 2003 WL 21523979 (S.D.N.Y. July 7, 2003); In re Gaming Lottery Sec. Litig., 58 F. Supp. 2d 62 (S.D.N.Y. 1999).

To apply our securities laws to these transnational securities frauds necessarily involves some extraterritorial application of United States laws because, by definition, not all of the fraudulent conduct occurs in the United States, nor are all the wrongdoers or victims necessarily in the United States. See, e.g., In re Alstom SA Sec. Litig., 406 F. Supp. 2d 346, 380 (S.D.N.Y. 2005) (describing transnational securities frauds). The issue becomes, therefore, how and where to draw the line with respect to application of the antifraud provisions of the United States securities laws.

> Complicating this inquiry are the commercial realities associated with modern international securities trading. Often these transactions involve multiple components, participants and events centered in several countries. The executives and directors of the company answerable for the wrongdoing may be headquartered in one country.

> The false representations may be contained in securities disclosure statements registered or in public announcements published in various other nations. The lawyers, accountants and underwriters who prepared the prospectuses and related documents may have coordinated their drafting activities and structuring of the transaction in yet a different jurisdiction. The marketing of the investments may take place in exchanges around the world. Hence, the conduct constituting the charged fraud causing the asserted financial losses is rarely a single act readily traceable in its entirety to a discrete time and place. Rather, more commonly, the alleged misdeeds may comprise but one aspect of a scheme on a larger scale, a link in a transactional chain forming a continuum that spreads out to multiple jurisdictions. Identifying where the charged fraud starts and where it culminates, and what comprises the numerous material points and participants in the transactions in between, inevitably presents formidable challenges.

Id. at 372 (footnote omitted).

2. Courts Have Developed a Conduct Test and an Effects Test for Resolving Questions of the Transnational Application of the Antifraud Provisions.

The text of the securities laws is silent as to the transnational reach of these laws. See Itoba Ltd v. LEP Group PLC, 54 F.3d 118, 121 (2d Cir. 1995). In 1934, "Congress did not consider how far American courts should have jurisdiction to decide cases involving predominantly foreign securities transactions with some link to the United States. The web of international connections in the securities markets was then not nearly as extensive or complex as it has become." Zoelsch

v. Arthur Anderson & Co., 824 F.2d 27, 30 (D.C. Cir. 1987). In the absence of clear Congressional guidance, the courts have attempted "[t]o discern 'whether Congress would have wished the precious resources of the United States courts and law enforcement agencies to be devoted to'" such transnational securities transactions. Europe and Overseas Commodity Traders, S.A. v. Banque Paribas London, 147 F.3d 118, 125 (2d Cir. 1998). As courts have acknowledged, this inquiry has largely been guided by "policy considerations and the court's best judgment." Kauthar SDN BHD v. Sternberg, 149 F.3d 659, 664 (7th Cir. 1998).

Two tests have emerged to determine the reach of the antifraud provisions: the effects test and the conduct test. See Alfadda v. Fenn, 935 F.2d 475, 478 (2d Cir. 1991); Itoba Ltd., 54 F.3d at 121-22. Satisfaction of either test alone, or an "admixture or combination of the two," affords jurisdiction. Itoba Ltd., 54 F.3d at 122. The effects test centers its inquiry on whether domestic investors or markets are affected as a result of actions occurring outside of the United States. Banque Paribas, 147 F.3d at 125. See also Psimenos v. E.F. Hutton & Co., 722 F.2d 1041, 1045 (2d Cir. 1983). By contrast, the conduct test focuses "on the nature of [the] conduct within the United States as it relates to carrying out the alleged fraudulent scheme," Psimenos, 722 F.2d at 1045, on the theory that "Congress would not want the United States to become a base for fraudulent activity harming foreign

investors." Banque Paribas, 147 F.3d at 125. A related purpose underlying the conduct test is ensuring international reciprocity; by extending our securities laws to prohibit fraudulent conduct here that injures overseas investors, the United States can reasonably expect other countries' laws to offer comparable protection to prevent fraudulent conduct overseas that is directed towards our investors. See IIT v. Vencap, Ltd., 519 F.2d 1001, 1017 (2d Cir. 1975). See also SEC v. Kasser, 548 F.2d 109, 116 (3d Cir. 1977).

3. Plaintiffs Rely Solely on the Conduct Test.

The parties agree that this case only implicates the conduct test. "The chronic difficulty with [that test] has been describing, in sufficiently precise terms, the sort of conduct occurring in the United States that ought to be adequate to trigger American regulation of the transaction." Kauthar, 149 F.3d at 665. "Indeed, the circuits that have confronted the matter have articulated a number of methodologies." Id.

The District of Columbia Circuit, for example, has advanced the most restrictive approach, requiring that the domestic conduct at issue must itself constitute a securities violation. Zoelsch v. Arthur Anderson & Co., 824 F.2d 27, 31 (D.C. Cir. 1987) ("[J]urisdiction will lie in American courts where the domestic conduct comprises all the elements of a defendant's conduct necessary to establish

[a violation of the antifraud provisions].”). The other courts of appeals that have considered the issue have, instead, required that the conduct in the United States needs to be a material to the overseas’ investors losses, but have not required that all the elements of the violation occur in the United States. [2] See, e.g., Kauthar, 149 F.3d at 666 (7th Cir.) (domestic conduct must be “material” and “substantial”); Robinson v. TCI/US West Communications Inc., 117 F.3d 900, 905 & n.10 (5th Cir. 1997) (same); Grunenthal GmbH v. Hotz, 712 F.2d 421, 425 (9th Cir. 1983) (domestic conduct be “material” and “significant” to the furtherance of the scheme); Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc., 592 F.2d 409, 421 (8th Cir. 1979) (same); Psimenos v. E.F. Hutton & Co., Inc., 722 F.2d 1041, 1045 (2d Cir. 1983) (domestic conduct must be “material” and “substantial”); SEC v. Kasser, 548 F.2d 109, 114, 115 (3d Cir. 1977) (“some activity” in the United States that is “essential to the plan to defraud”). [3]

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[2] To the extent that any distinction can be discerned among the Circuits that require materiality, it has been asserted that the Third, Eighth, and Ninth Circuits require “some lesser quantum of conduct” than the Second, Fifth, and Seventh Circuits. Kauthar, 149 F.3d at 666. See also Psimenos, 722 F.2d at 1046 n.6. Recognizing that this Court is bound by prior precedent, in this brief we do not address the standards followed by other Courts of Appeals.

[3] Notably, the District of Columbia Circuit in Zoelsch appeared to believe it was applying this Court’s test. Compare Zoelsch, 824 F.2d at 31 (“The Second Circuit’s rule seems to be that jurisdiction will lie in American courts where the

(continued...)

As discussed below, the Second Circuit's decisions have developed the law on a case-by-case basis without explicitly articulating the generally applicable standard. As a result, there has been uncertainty in the district courts. See, e.g., In re Alstom SA Sec. Litig., 406 F. Supp. 2d 346, 372-76 (S.D.N.Y. 2005). For that reason, the Commission recommends that this Court adopt the standard that we propose.

B. This Litigation

This is a class action on behalf of non-U.S. shareholders of National Australia Bank who purchased stock between April 1, 1999, and September 3, 2001. [4] The complaint alleges that the defendants violated section 10(b) of the Exchange Act and Rule 10b-5. As explained below, the complaint alleges that the defendants made false and misleading statements overseas to the class members concerning the operations of a United States subsidiary, but that the fraudulent

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[3](...continued)
domestic conduct comprises all the elements of a defendant's conduct necessary to establish a violation [of the antifraud provisons]."), with Kauthar, 149 F.3d at 665 n.10 ("We share the reservations of the Fifth Circuit as to whether the District of Columbia Circuit accurately portrayed the Second Circuit's jurisprudence.").

[4] As originally styled, this class action included United States residents who purchased ADR interests (see infra note 5) in defendant NAB during the class period. In the same order in which jurisdiction was held lacking as to the foreign class members' claims, the district court dismissed the lead domestic plaintiff because he did not suffer a loss during the statutory look-back period.

scheme was hatched in the United States and the fraudulent data was generated here. The complaint further alleges that the false and misleading statements artificially inflated the prices of NAB's securities trading overseas and eventually caused losses to the class members.

1. The Allegations in the Complaint

Defendant NAB is organized under the laws of Australia and is headquartered in Melbourne, Australia, and its ordinary shares (the Australian equivalent of common stock) trade on the Australian securities exchanges. A very limited number of NAB's American Depository Receipts (representing less than 1.1% of NAB's ordinary shares) traded on the New York Stock Exchange, but none of the class members remaining in this suit are alleged to have purchased these instruments. [5]

At all relevant times, HomeSide Lending, Inc., located in Jacksonville, Florida, was a wholly-owned subsidiary of NAB. HomeSide was a mortgage service provider and its principal source of income was the fees that it generated

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[5] An ADR is a negotiable certificate issued by a United States depository bank that represents a specified number of shares of a foreign security that have been deposited with a foreign branch of the depository.

for servicing mortgages. [6] The present value of those fees was calculated using an internal valuation model, and was booked by NAB on its balance sheet as an asset called Mortgage Servicing Rights.

The allegations of securities fraud in this suit stem from the calculation of HomeSide's MSR. In order to calculate the present value of the MSR, HomeSide employed valuation models and software systems that sought to account for the various economic forces that impact prepayment rates by factoring in projected future interest rates and other projected future economic conditions. The complaint alleges that between 1998 and 2001, HomeSide, under the direction of its three principal executive officers (defendants Hugh Harris, Kevin Race, and W. Blake Wilson), had been deliberately overvaluing HomeSide's MSR by modifying the various economic assumptions used to produce the MSR valuations, purportedly overestimating the present value of the MSR by hundreds of millions of dollars.

The complaint further alleges that this overvaluation scheme was hatched by the HomeSide defendants in the United States and that the fraudulent overvaluations were also generated in the United States and then transmitted to

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[6] In addition to HomeSide, NAB owned other operations in the United States, including Michigan National Bank. NAB's United States operations accounted for not more than 13% of its assets at all times relevant to this suit.

Australia for incorporation into NAB's financials. Although not initially a knowing party to the fraud, the NAB defendants (i.e., NAB and its CEO, Frank Cicutto) are alleged to have learned in July 2000 that the HomeSide defendants were manipulating the MSR valuation model. Nonetheless, the NAB defendants proceeded to release this fraudulent information to investors in Australia through NAB's annual reports, as well as in press releases that asserted HomeSide's profitability and its contribution to NAB's overall profitability. [7]

In July 2001, and then again in September 2001, NAB announced that it would book an approximately $2.1 billion writedown stemming from the overvaluation of HomeSide's MSR. Following the September writedown, NAB's ordinary shares fell by nearly 13% on the Australian market.

2. The District Court's Order Dismissing the Case

On October 25, 2006, the district court dismissed the claims of the foreign plaintiffs, holding that the antifraud provisions of the securities laws do not reach

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[7] NAB also purportedly included the false information in filings with the Commission with respect to the ADRs. The parties agree that these filings do not form a part of the jurisdictional inquiry in this class action suit because none of the overseas class members relied on these filings. The HomeSide defendants are also alleged to have made several exaggerated statements in the United States, but here again, the parties appear to agree that these statements were not relied upon by the overseas class members, and thus these statements are not relevant to the jurisdictional inquiry.

the foreign plaintiffs' claims.[8] The district court applied the conduct test to the allegations, comparing the conduct at issue here with the conduct at issue in two earlier Second Circuit decisions that reached opposite conclusions about jurisdiction: Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 985 (2d Cir. 1975), which rejected jurisdiction, and SEC v. Berger, 322 F.3d 187, 193 (2d Cir. 2003), which upheld jurisdiction. The district court reasoned that, "[o]n balance, it is the foreign acts – not any domestic acts – that 'directly caused' the alleged harm here," and thus held that jurisdiction is lacking with respect to the overseas class members' claims.

ANALYSIS

I. The Second Circuit's Case Law Relating to the Conduct Test Has Proven Difficult to Apply.

A review of a number of this Court's cases applying the conduct test reveals both the factors to which the court has looked, and the uncertainties of applying

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[8] It is assumed for purposes of resolving the subject matter jurisdiction issue that the complaint states a cause of action, but there is a dispute between the parties as to whether the conduct of the Florida subsidiary and the other American defendants amounts to only aiding and abetting the violation allegedly committed by the parent bank, in which case the subsidiary could be liable in an action brought by the Commission but not in one for damages brought by a private party. See Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc., 128 S. Ct. 761 (2008). We do not address that issue.

those factors to specific fact patterns. This Court itself has cautioned that "'the presence or absence of any single factor which was considered significant in other cases dealing with the question of federal jurisdiction in transnational securities cases is not necessarily dispositive' in future cases." IIT v. Cornfeld, 619 F.2d 909, 918 (2d Cir. 1980).

Moreover, district courts in the Second Circuit have had difficultly understanding and applying the case law. Compare Froese v. Staff, 2003 WL 21523979 (S.D.N.Y. July 7, 2003) with In re Gaming Lottery Secur. Litig., 58 F. Supp. 2d 62 (S.D.N.Y. 1999). One district court, after examining the case law beginning with Bersch, has asserted that this difficulty arises from an "apparent shift in emphasis from a test of strict causation to one of materiality of the domestic acts." In re Alstom SA Sec. Litig., 406 F. Supp. 2d 346, 373 (S.D.N.Y. 2005).

A. Overview of the Relevant Second Circuit Case Law.

- *Bersch – jurisdiction should be exercised only when United States conduct "directly" causes investors' losses, not when the conduct is merely preparatory or is relatively small in comparison to the conduct abroad.* Bersch v. Drexel Firestone Inc., was a class action in which certain conduct in connection with offerings of securities of a foreign issuer took place in the United States, including

such activities as meetings of various participants in the offering, drafting of parts of offering documents, and retention of and consultation with accountants. 519 F.2d 974, 985 n.24 (2d Cir. 1975) (Friendly, J.) (listing activities).[9] Nevertheless, the Court considered the transaction to be "predominantly foreign," 519 F.2d at 985, in that the issuer was foreign, all the offering documents were finalized overseas, and the offers and sales occurred there. 519 F.2d at 987. This Court concluded that a United States court should not exercise jurisdiction over claims brought by foreign plaintiffs when the underwriting related to a foreign issuer clearly identified with a foreign country and the fraud was committed overseas. If there was fraud, this Court explained, it "was committed by placing the allegedly false and misleading prospectus in the purchasers' hands," and the "final prospectus emanated from a foreign source." Id. The Bersch Court saw no reason to extend United States jurisdiction to "cases where the United States activities are merely preparatory or take the form of culpable nonfeasance and are relatively small in comparison to those abroad." Thus, the antifraud provisions of the

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[9] Prior to this case, Bersch has been the only transnational securities-fraud class action involving foreign class members that this Court (or any court of appeals) has considered. Although the Bersch Court set forth the additional policy considerations that *might* come into play in an transnational securities-fraud class action, the court did not purport to apply any form of heightened standard in deciding the case. See supra note 1.

securities laws do not apply "to losses from sales of securities to foreigners outside the United States unless acts (or culpable failures to act) within the United States directly caused such losses." Id. at 993.

- *Vencap – Congress did not intend for the United States to be used as a base for manufacturing fraudulent devices.* In IIT v. Vencap, Ltd., handed down the same day as Bersch, a Luxembourg investment trust brought suit alleging fraud, conversion and corporate waste by a Bahamian corporation and various individual defendants. 519 F.2d 1001 (2d Cir. 1975) (Friendly, J.). The course of dealings was complex, the precise nature of plaintiff's allegations was unclear, and the district court's findings so deficient that the case was remanded for further explanations, so this Court did not reach a definite holding on whether jurisdiction was permissible. But the Vencap Court did lay out the broad principles under which United States conduct injuring overseas investors could fall within the ambit of the antifraud provisions. The Court reasoned that Congress did not intend "to allow the United States to be used as a base for manufacturing fraudulent security devices for export, even when these are peddled only to foreigners," observing that the United States would "surely look askance if one of our neighbors stood by silently and permitted misrepresented securities to be poured into the United States." Id. at 1017. Echoing the holding in Bersch, the

Court cautioned that its ruling that jurisdiction might be found on the ground that the United States should not be used as a base for manufacturing fraud was "limited to the perpetration of fraudulent acts themselves and does not extend to mere preparatory activities or the failure to prevent fraudulent acts where the bulk of the activity was performed in foreign countries." Id. at 1018.

- *Cornfeld – whether injury was "directly" caused by United States activity depends on how much (or how little) was done overseas.* As relevant to our discussion here, IIT v. Cornfeld, involved debentures that were offered and sold almost entirely overseas. 619 F.2d 909 (2d Cir. 1980) (Friendly, J.). Defendants urged that jurisdiction was therefore wanting under Bersch because the conduct in the United States did not directly cause plaintiffs' alleged injuries. This Court rejected that argument as taking the holding of Bersch out of context. Specifically, in contrast to the offering in Bersch, the overseas offering in Cornfeld was in essence an offering of securities of an American issuer that was closely coordinated with a United States offering of securities in the same issuer. As a result, the important efforts in making the offering – including the location of the underwriters, the drafting of the prospectuses, and all of the accounting work – occurred in the United States, and little of importance happened overseas. In other words, "[d]etermination whether American activities 'directly' caused losses to

foreigners depends not only on how much was done in the United States but also on how much (here how little) was done abroad." Id. at 920-21.

- *Psimenos – losses are "directly" caused by United States conduct when defendant engages in substantial conduct that is material to the completion of the fraud here.* Psimenos v. E.F. Hutton & Co., was a private action brought under the Commodity Exchange Act, but the court applied cases construing subject matter jurisdiction under the antifraud provisions of the securities laws. 722 F.2d 1041, 1044 (2d Cir. 1983). Plaintiff was a Greek national who opened an account at defendant's Athens office, and most of the fraudulent representations that gave rise to the cause of action were made there. However, plaintiff's commodity transactions were executed on American markets. After reviewing its prior decisions, this Court concluded that defendant's activities in the United States in furtherance of the fraudulent scheme were "material" and "substantial enough to establish subject matter jurisdiction." 722 F.2d at 1046. And the court characterized Bersch as being concerned that the United States entertain suits by aliens "only where conduct material to the completion of the fraud occurred in the United States." Id.

- *Berger – losses are directly caused by United States conduct when a fraudulent scheme is masterminded and implemented here.* The defendant in SEC

v. Berger was a resident of New York who operated an investment company organized under the laws of the British Virgin Islands that was held almost entirely by foreigners. 322 F.2d 187 (2d Cir. 2003). As part of a scheme to hide fund losses, the defendant sent false account data to the fund administrator in Bermuda, who used that data to generate inaccurate account statements that were mailed to investors. Relying on Bersch, defendant claimed that his conduct in the United States was merely preparatory because the final steps of preparing the statements and delivering them to investors took place overseas. The court disagreed finding that material and substantial conduct occurred in the United States for jurisdiction to lie, because defendant "masterminded and implemented" the fraudulent scheme from the United States – "the fraudulent conduct was carried out entirely" by defendant in New York. The foreign conduct in the case – preparation and mailing of statements from Bermuda – "was not itself fraudulent" because the fund administrator was merely following defendant's instructions, which provided a means for defendant "to distribute false information that he had already fraudulently concocted in the United States." [10]

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[10] Additional Second Circuit cases involving the extraterritorial reach of the antifraud provisions include: Europe and Overseas Commodity Traders v. Banque Paribas London, 147 F.3d 118 (2d Cir. 1998); Itoba Ltd. v. LEP Group PLC, 54 F.3d 118 (2d Cir. 1995); AVC Nederland B.V. v. Atrium Inv. Partnership, 740 (continued...)

B. The Second Circuit's Decisions Do Not Provide a Clear Answer to the Correct Resolution of the Jurisdictional Issue in this Case.

This Court's previous cases identify a number of potentially relevant questions, but they do not afford clear answers. For example, under these circumstances, should the domestic conduct be considered "merely preparatory," given that more conduct that was integral to the fraud occurred in the United States than occurred in Bersch, and the conduct reached a greater degree of completion, but the scheme could not be completed until the information was incorporated into the issuer's statements in Australia and distributed to investors there? Or should the conduct be considered sufficiently "substantial" and "material to the completion of the fraud" that it "directly" caused the injury? Was the overall scheme masterminded and implemented here or in Australia, given that it required the concurrence of wrongdoers in both places, and how should this issue be assessed under this Court's existing case law?

In addition to not pointing clearly to the answers to these questions, the existing Second Circuit case law may not provide an optimal decisional

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[10](...continued)
F.2d 148, 154 (2d Cir. 1984); Leasco Data Processing Equipment Corp. v. Maxwell, 468 F.2d 1326 (2d Cir. 1972) (Friendly, J.); Schoenbaum v. Firstbrook, 405 F.2d 200, rev'd on the merits, 405 F.2d 215 (2d Cir. 1968) (Friendly, J.). See also North South Finance Corp. v. Al-Turk, 100 F.3d 1046 (2d Cir. 1996).

framework for addressing future cases because the existing decisions have been decided on a case-by-case basis, without prioritizing the factors or arranging them in a unified test. In other words, while this may be a close case under the Second Circuit case law, it perhaps appears a harder case than it has to be as a result of the way this Circuit's law has developed. Therefore, the Commission believes that this Court should set forth an explicit test that both addresses the concerns reflected in the Circuit's decisions and offers more uniformity of analysis and predictability of results.

II. Adoption of the Commission's Proposed Articulation of the Conduct Test Would Bring Needed Clarity and Would Shift the Inquiry from a Case-By-Case Analysis that Turns on "Very Fine Distinctions."

The Commission recommends adoption of the following formulation of the conduct test:

> 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.

The test we propose describes when an injury is considered to be sufficiently "directly" caused by United States conduct to support jurisdiction, reflecting the fact that in Berger this Court upheld jurisdiction even though the last event in

effectuating the fraudulent scheme did not occur in this country.

Furthermore, the formulation we recommend builds on the existing approach of this Circuit, but brings it together in a unified standard that will provide greater guidance to lower courts in resolving future cases. In Psimenos, the Court stated that domestic conduct must be "material to the completion of the fraud," 722 F.2d at 1046, and must have been "substantial acts in furtherance of the fraud," id. at 1045. Likewise, in Berger, the Court stated that the domestic conduct must "materially relate[] to the fraud" and must constitute "substantial acts in furtherance of the fraud." 322 F.3d at 193. See also Kauthar SDN BHD v. Sternberg, 149 F.3d 659, 667 (7th Cir. 1998) (expressly adopting the Second Circuit's conduct test; stating: "antifraud provisions of the securities laws [apply] when the conduct occurring in the United States directly causes the plaintiff's alleged loss *in that the conduct forms a substantial part of the alleged fraud and is material to its success*." (emphasis added)).

The materiality inquiry would ensure that the domestic conduct was an integral – not incidental or ancillary – link in the chain of events in the transnational fraud leading to the overseas investors' losses. [11] Cf. Psimenos, 722

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[11] The use of the term "materiality" for the jurisdictional inquiry under the conduct test should not be confused with the different concept of "materiality" as (continued...)

F.2d at 1046 ("conduct material to the completion of the fraud" is more than "mere preparatory activities, and conduct far removed from the consummation of the fraud"). If the domestic conduct is deemed material, then the analysis would turn to whether, under the totality of the circumstances, the domestic conduct was substantial in relation to the entire fraud. The substantiality showing would generally be satisfied by demonstrating that a sufficient quantum of conduct occurred in the United States to reasonably warrant application of the antifraud provisions in light of the competing policy concerns identified by this Circuit. Cf. Bersch, 519 F.2d at 987 (domestic conduct "relatively small in comparison to [conduct] abroad"). However, even limited conduct in the United States would satisfy the substantiality showing where the particular domestic conduct was highly significant to the fraud, such as, for example, where the conduct in question involves communicating the misrepresentations to foreign investors in or from the United States, cf., Gruenthal v. Hotz, 712 F.2d 421 (9th Cir. 1983), masterminding the scheme here, or using the United States as a base to consummate schemes concocted abroad, cf. Psimenos, 722 F.2d at 1047.

We believe this standard is consistent with the Court's prior cases. Those

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[11](...continued)
an element of a fraud violation. See Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988).

cases have indicated the result of the test's application to certain fact patterns, so it will not be necessary to apply the standard anew when those patterns recur. For instance, it is clear that jurisdiction exists when misrepresentations are made in this country. See Bersch, 519 F.2d at 986-87 (contrasting the facts of that case with the paradigmatic example of a gun fired from one country into another). Jurisdiction is appropriate when the mastermind of a fraudulent scheme is operating from the United States. See Berger, 322 F.3d at 195. And jurisdiction lies when the transaction that consummates the fraud occurs on United States markets. See Psimenos, 722 F.2d at 1046.

In our view, the standard appropriately accommodates the policy concerns that underlie this Circuit's case law. This proposed standard would enable the courts to address situations in which the United States is being used as a base for fraudulent international securities schemes, while at the same time, it would allow our courts to avoid "adjudicating disputes which have little in the way of a significant connection to the United States." Kauthar, 149 F.3d at 667.

Moreover, adoption of this standard would help address at least two key uncertainties that appear to surround the district courts' application of the Second Circuit's existing case law. *First*, the proposed standard makes clear that the "direct cause" of the foreign investors' loss includes more than simply last action

in the fraudulent chain (contrary to the defendants' argument).[12] Thus, for example, jurisdiction may lie in cases where the fraudulent statements are mailed from outside the United States, assuming that the domestic conduct was otherwise material to the fraud's success and a substantial part (either in a qualitative or quantitative sense) of the overall securities fraud.

Second, the Commission's proposed articulation reduces the uncertainty about determining whether conduct is "merely preparatory," a standard which seems to call for relatively fine distinctions about what constitutes preparatory while offering little guidance as to how those distinctions should be made. Instead, the proposed standard makes the inquiry more general by focusing on whether a material and substantial portion of the fraud occurred in the United States. In this way, it affords needed flexibility for courts to address the "numerous combinations and permutations of, for example, the parties and the types, places, timing and effects of relevant conduct that typically bear upon a determination of whether an American court may properly exercise jurisdiction to consider the merits of what are essentially foreign disputes." In re Alstom SA Sec.

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[12] We have attempted in our proposed formulation to build on the language of the existing Circuit case law, but we note that continued use of the term "directly" in articulating the conduct standard as it is presently applied in this Circuit may introduce unnecessary confusion into the analysis by suggesting a last-action requirement.

Litig., 406 F. Supp. 2d at 371.

To be sure, this standard will not provide absolute clarity, and indeed no standard likely would short of the District of Columbia Circuit's requirement that the antifraud provisions only apply where all of the elements of the securities fraud violation occurred in the United States. See supra pages 8-9. In our view, however, the approach of the District of Columbia Circuit would simply allow too much transnational fraudulent conduct to escape the reach of the antifraud provisions, thereby possibly permitting the United States to serve as a base for the exportation of securities fraud schemes. By making clear that the proper focus is whether a material and substantial portion of the fraudulent conduct occurred here, the Commission's proposed standard would help move the focus away from drawing the "very fine distinctions" that district courts are currently left to make under existing Second Circuit case law and would provide a clearer test for addressing the transnational issue.

The defendants and *amici* argue that the antifraud provisions should be construed to have limited transnational application in order to preserve international comity. In making their comity argument, defendants and *amici* rely heavily on a recent Supreme Court decision delineating the transnational application of the antitrust laws. F. Hoffmann-La Roche Ltd. v. Empagran S.A.,

542 U.S. 155, 164 (2004). The Commission believes that application of that case in this context is not appropriate because the comity concerns raised by the application of United States antitrust laws overseas are generally more serious than those raised by application of the securities antifraud provisions. See RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW § 416, Note 3 (1987) ("In contrast to regulation under the antitrust laws, which not infrequently involved prohibition of conduct which another state favored or required, ... United States securities regulation ... has not resulted in state-to-state conflict."). This is particularly so in the context of prohibiting securities fraud where the potential for conflict is less, as opposed to administrative or other regulatory requirements. [13]

The Commission also believes that the proposed standard sufficiently addresses the *amici*'s concern that an over-extension of the United States securities laws to foreign corporations whose shares trade overseas may discourage their investment in the United States. This concern must be balanced against the principle that the United States should not be used as a base for engaging in fraudulent conduct that may injure foreign investors. The

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[13] Both this Circuit and the Restatement (Third) of Foreign Relations Law recognize that the antifraud provisions of the securities laws should be applied broadly to transnational conduct. See Europe and Overseas Commodity Traders, S.A. v. Banque Paribas London, 147 F.3d 118, 125 (2d Cir. 1998); RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW § 416, cmt. A (1987).

Commission believes that the standard proposed here strikes this balance appropriately by affording jurisdiction only where the conduct in the United States constitutes a substantial portion of the fraud that is material to the success of the scheme.

Finally, the *amici*'s concerns are largely with the potential economic effects of class actions, [14] not with Commission enforcement actions or named foreign plaintiffs' suits. As a result, to the extent that the Court is persuaded by the *amici*, it would be more appropriate to address those issues by developing a heightened jurisdictional standard for class actions, see supra note 1. To be sure, Commission enforcement actions *might* be thought to pose a threat of similar magnitude to foreign companies through possible disgorgement awards and civil penalties, but any actual threat to comity that materializes could be accommodated by the Commission as it decides whether to issue a formal order of private investigation, see Securities Exchange Act § 21(a)(1), 15 U.S.C. § 78u(a)(1), initiate litigation, or accept a settlement.

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[14] Some of the literature refers to these suits as "F-Cubed" class actions. See, e.g., JOHN C. COFFEE, JR., *Foreign Issuers Fear Global Class Actions*, THE NATIONAL LAW JOURNAL (June 14, 2007).

III. Under the Commission's Proposed Articulation of the Conduct Test, the Antifraud Provisions Would Apply Here.

The Commission believes that the defendants' domestic conduct was both material to the scheme's success and a substantial part of the alleged fraud.

Based on the allegations in the complaint, the Commission believes that the defendants' conduct in the United States was material to the successful completion of the fraud. The information that made the statements in Australia false was generated in the United States with the expectation that it would be distributed to foreign investors. Without this domestic misconduct, there would have been no fraudulent release of information in Australia nor a resulting inflation of NAB's stock. Thus, the domestic conduct was an integral link in the chain of events leading to the overseas investors' losses.

Likewise, the HomeSide defendants are alleged to have conceived the scheme in Florida. See, e.g., Vencap,519 F.2d at 1017-18 (allegations suggested scheme conceived in New York); Berger, 322 F.3d at 194-94 (evidence demonstrated scheme conceived in New York). The HomeSide defendants then took numerous significant steps in the United States to perpetrate that scheme by manipulating the assumptions in HomeSide's MSR valuation modes, generating the fraudulent valuations using those models, and then transmitting the fraudulent

valuations to NAB's headquarters in Australia with the knowledge that this information would be incorporated in the parent's financials. In our view, this domestic conduct was a substantial part of this transnational fraud. [15]

[15] As previously stated, see supra notes 4, 5 & 7, defendant NAB made filings with the Commission containing the allegedly fraudulent information and the company's ADRs traded on an American exchange. This conduct in the United States alone would have afforded the Commission jurisdiction to bring an enforcement action. In this brief, however, we assume the only relevant conduct is that alleged by the plaintiffs as a basis for jurisdiction over the foreign class members' claims.

CONCLUSION

In the Commission's view, at least in the context of Commission enforcement actions and suits by named foreign plaintiffs, the antifraud provisions of the securities laws apply to transnational securities frauds that principally or exclusively result in losses to overseas investors so long as the domestic conduct was both material to the scheme's success and a substantial part of the alleged fraud. Furthermore, the Commission believes that the allegations in this case satisfy this proposed standard.

Respectfully submitted,

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September 17, 2008

CERTIFICATE OF COMPLIANCE

1. This brief complies with the type-volume limitation of Fed. R. Approximately P. 32(a)(7)(B), because: this brief contains 7,000 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirements of Fed. R. Approximately P. 32(a)(5) and the type-style requirements of Fed. R. Approximately P. 32(a)(6) because: this brief has been prepared in proportionally spaced typeface using WordPerfect 11 in 14 point Times New Roman type.

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William K. Shirey

CERTIFICATE OF SERVICE

I hereby certify that on this 17th day of September, 2008, I caused ten copies of the BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION AS *AMICUS CURIAE*, IN RESPONSE TO THE COURT'S REQUEST, to be served, via Federal Express overnight delivery, on the Clerk for the United States Court of Appeals for the Second Circuit. Pursuant to agreement with the various counsel, I caused an electronic pdf of the brief to be transmitted to the following email addresses:

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