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Class Actions

Death of the Worldwide Class?

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The growth of majority-foreign classes and the arrival of overseas investors as lead plaintiffs rank among the major developments in U.S. securities fraud litigation over the past decade. Two recent decisions by judges in the Southern District of New York, however, cast serious doubt on continued access to American courts for many foreign class claimants, both in securities cases and in class actions generally.

Since the 1970s, courts have limited international investors' claims under the U.S. securities laws to cases involving a substantial amount of activity within the United States, holding that without such activity courts lack ''subject matter jurisdiction'' (perhaps a misnomer[1]) over non-U.S. claims. Courts have universally employed this ''conduct test,'' albeit with considerable inconsistency as to both the required amount of U.S. conduct,[2] and the particular types of acts deemed relevant.[3]

The recent Southern District decisions, however, create a new barrier to international participation in American class actions, even if sufficient relevant conduct occurred in the United States. In both decisions, the courts asked whether foreign courts would recognize a class action judgment entered in the U.S. case, and held that a class action is ''superior to other available methods'' for adjudicating claims by a country's citizens, as required under Federal Rule of Civil Procedure (''Rule'') 23(b)(3), only if the courts of that coun-

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[1] While securities cases consistently treat the extraterritorial reach of the securities laws as implicating subject matter jurisdiction, the issue should probably be termed ''jurisdiction to prescribe,'' *see* Restatement (Third) of Foreign Relations Law § 401 cmt. c (1987), and treated as an element of the plaintiff's claim. This distinction has substantial procedural consequences. *See United Phosphorus Ltd. v. Angus Chemical Co.*, 322 F.3d 942 (7th Cir. 2003) (decision turned on whether extraterritorial reach of the Sherman Act controlled court's subject matter jurisdiction, or was merely an element of the plaintiff's claim). The issue was raised, but not decided, by Judge Kaplan in *In re Parmalat Securities Litigation*, 497 F. Supp. 2d 526, 528-29 (S.D.N.Y. 2007).

[2] *See Kauthar SDN BHD v. Sternberg*, 149 F.3d 659, 665 (7th Cir. 1998) (noting the ''disparity in approach'' among the circuits).

[3] *Compare Froese v. Staff*, 2003 WL 21523979 (S.D.N.Y. July 7, 2003) (Owen, J.) (channel stuffing by U.S. subsidiary did not confer jurisdiction) *with In re Gaming Lottery Sec. Litig.*, 58 F. Supp. 2d 62, 74 (S.D.N.Y. 1999) (Patterson, J.) (misrepresentations with respect to U.S. operations and regulatory approvals did confer jurisdiction). In the Second Circuit's most recent pronouncement on these issues, *Morrison v. National Australia Bank Ltd.*, 547 F.3d 167, 177 (2d Cir. 2008), the court avoided articulating generally-applicable principles, pointedly limiting its holding to the ''particular mix of factors'' before it.

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try were ''more likely than not'' to recognize a U.S. class action judgment and accord it res judicata effect.

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Judge Holwell's May 2007 decision in *In re Vivendi Universal, S.A. Securities Litigation*, 242 F.R.D. 76, 95 (S.D.N.Y. 2007), was the first to apply this analysis. There, the court surveyed a series of decisions extending back to Judge Henry Friendly's seminal 1975 opinion in *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 993 (2d Cir. 1975), and concluded that ''res judicata concerns have been appropriately grafted onto the [Rule 23] superiority inquiry.'' In *Bersch*, Judge Friendly concluded – in a case where the fraud at issue failed the ''conduct test'' – that the court should not exercise pendent jurisdiction over state-law claims by a class of foreign investors because, among a number of other factors, ''uncontradicted affidavits'' indicated that many foreign courts would not recognize a U.S. class judgment, and ''if defendants prevail against a class they are entitled to a victory no less broad than a defeat would have been.''

Applying these principles, the court in *Vivendi* then conducted a searching review of the law of five European countries and found that courts in France, England and the Netherlands would likely recognize a U.S. judgment, while German and Austrian courts would not. 242 F.R.D. at 95, 105. The court then ''elect[ed] to proceed with caution'' in certifying a class and determined to exclude German and Austrian citizens from the class based on this factor alone.

New Law Made

By treating foreign judgment recognition as a decisive factor in class certification, *Vivendi* made new law. In the handful of prior decisions discussing judgment recognition as a relevant consideration under Rule 23, all had treated it as one among many factors, and several of the opinions had expressly noted its limited importance.[4]

There are good reasons for declining to make foreign judgment recognition outcome-determinative. First, its practical relevance is quite limited. As the court acknowledged in *Vivendi*, defendants' actual risk of exposure to subsequent litigation is extremely remote, given the impediments to collective litigation overseas, combined with the fact that such litigation would necessarily follow an adverse decision in the U.S. case. The highly unlikely prospect of relitigation is perhaps best illustrated by the fact that according to the foreign law experts retained by both sides in *Vivendi*, the res judicata question had *never* actually been litigated in *any* of the five jurisdictions at issue.

Resolving the judgment recognition issue also requires tremendous expenditure of time and resources by parties and courts. In *Vivendi*, for example, the court weighed ''voluminous competing expert declarations'' from nine separate foreign-law scholars, and devoted nearly 22 pages in its decision to evaluating them. The judgment recognition issue also forces courts to address unresolved questions of foreign law – what the Second Circuit has criticized in another context as ''speculative forays into legal territories unfamiliar to federal judges'' resulting in ''a costly, time-consuming, and inherently unreliable method of deciding'' a controversy. *Euromepa S.A. v. R. Esmerian, Inc.*, 51 F.3d 1095, 1099-1100 (2d Cir. 1995).

Finally, if resolution of the issue were mandated by statute or binding precedent, or if it implicated an important principle of law, the effort might be worth the candle. In fact, however, there is no authoritative basis for the inquiry. In *Bersch*, Judge Friendly raised the res judicata issue in the course of discussing pendent jurisdiction over state law claims and cited the leading decision on that issue, *United Mine Workers of America v. Gibbs*, 383 U.S. 715 (1966) – not a class action – as the basis for his conclusion that allowing state law class claims to proceed would be an abuse of discretion. The decision also specifically noted that class superiority was an issue ''which we leave to the district court since further factual inquiry is needed.'' 519 F.2d at 997. There is therefore ample reason to conclude, as Judge Sweet did in *In re Lloyd's American Trust Fund Litigation*, No. 96 CIV. 1262 (RWS), 1998 WL 50211, at *15 (S.D.N.Y. Feb. 6, 1998), that the res judicata analysis in *Bersch* did not implicate Rule 23 at all.

Whether or not *Bersch* addressed Rule 23, however, major changes in the law since the case was decided undermine the continued salience of Judge Friendly's res judicata concerns. In 1975, the law of issue preclusion still required mutuality for offensive use: a defendant was barred from relitigating an issue only against the plaintiffs in the earlier suit. In addition, modern Rule 23 had been promulgated only a few years earlier with this principle in mind, prohibiting parties from waiting to see whether a class case turned out favorably before intervening in the action – so-called ''one-way intervention.'' *See* 1966 Advisory Committee Note to Rule 23(c)(3). Subsequently, however, the Supreme Court decided *Parklane Hosiery Co. v. Shore*, 439 U.S. 322

[4] *See Cromer Finance Ltd. v. Berger*, 205 F.R.D. 113, 135 (S.D.N.Y. 2001) (Cote, J.); *In re Lloyd's Am. Trust Fund Litig.*, No. 96 CIV. 1262 (RWS), 1998 WL 50211, 15 (S.D.N.Y. Feb. 6, 1998) (Sweet, J.).

Note to Readers

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(1979), which approved offensive non-mutual collateral estoppel, barring a defendant who receives an adverse decision in one case from relitigating the issue in a subsequent case brought by another plaintiff. As both courts and commentators have recognized, this ''death of mutuality'' undermines the rationale for a firm prohibition against one-way intervention.[5] It also eliminates the rationale for giving weight – let alone decisive effect – to foreign judgment recognition in the Rule 23 superiority analysis. Simply stated, under present law, a defendant will ordinarily be bound by an adverse class action decision in subsequent litigation with a foreign claimant, *whether or not* the foreign party was a member of the class. In the language of *Bersch*, defendants now routinely face victories far less broad than a defeat would have been.

Vivendi Extended

Whatever the juridical and jurisprudential limitations of the *Vivendi* ruling, it was recently adopted and extended by Judge Marrero in *In re Alstom SA Securities Litigation*, 253 F.R.D. 266 (S.D.N.Y. 2008). Relying heavily on *Vivendi*, the court treated a foreign country's likely refusal to recognize a U.S. class judgment as dispositive of class action superiority and adopted what it termed the ''Probability Standard'' – requiring that ''Plaintiffs demonstrate that the Foreign Courts would probably recognize as preclusive any judgment rendered by this Court.'' Significantly, it also imposed on plaintiffs the burden of affirmatively ''demonstrating that 'foreign court recognition is more likely than not,' '' *Id.* at 282 (quoting *Vivendi*).

As in *Vivendi*, the court then conducted extensive analyses of the relevant countries' laws, upholding jurisdiction over claims against some defendants by English, Dutch and Canadian claimants. *Alstom* did part company with *Vivendi* in one significant respect, however: it concluded that France – the most important jurisdiction in both cases – would not recognize a U.S. class judgment and therefore that French investors should be excluded from the class. *Id.* at 287.

Wither the Worldwide Class?

If the holdings of *Vivendi* and *Alstom* are widely applied, their impact would be pervasive. First, by explicitly placing the burden on plaintiffs of showing that a class judgment will be held binding in the foreign jurisdiction, *Alstom* practically compels the end of worldwide classes: plaintiffs now need to selectively determine the countries for which they will incur the cost and burden of presenting proof of judgment recognition.

Second, courts have used the doubt as to whether a class judgment would be enforceable in certain countries as a basis for refusing to appoint investors from those countries – notably Germany – as lead plaintiffs. *See Borochoff v. Glaxosmithkline PLC*, 246 F.R.D. 201, 205 (S.D.N.Y. 2007).

Finally, while both *Vivendi* and *Alstom* involved non-U.S. companies and largely non-U.S. classes, much of the courts' legal analysis focused on the representative nature of the U.S. class action procedure, and their reasoning therefore applies with equal force to securities class actions against American companies by majority-U.S. classes, and to non-securities class actions generally.

As a result, if investors or other class claimants hail from a country where enforcement of a U.S. class action judgment is doubtful, there is a substantial question whether they can *ever* rely on a U.S. class case to obtain relief. Further, even if recognition by a country's courts is likely, claimants from that country will be permitted to join a class only if the lead plaintiffs in the case decide to include that country's citizens in the class definition and then make an affirmative showing that judgment recognition is more likely than not.

The *Vivendi* and *Alstom* decisions represent a significant development in prevailing law, with real implications both for the class device as an effective ''bill of peace'' and for foreign perceptions of access to justice in U.S. courts. The decisions and their progeny therefore deserve careful scrutiny.

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[5] 3 Alba Conte & Herbert Newberg, *Newberg on Class Actions* § 8:10 (4th ed. 2002) (''the intent of amended Rule 23 to avoid one-way intervention may have become largely academic in light of subsequent evolution in the law of offensive collateral estoppel without the need to afford mutuality of right to the defendants''); Mark W. Friedman, *Constrained Individualism in Group Litigation: Requiring Class Members to Make a Good Cause Showing Before Opting Out of a Federal Class Action*, 100 Yale L.J. 745, 753 (1990) (same); *Premier Elec. Constr. Co. v. Nat'l Elec. Contractors Ass'n*, 814 F.2d 358, 362 (7th Cir. 1987) (Easterbrook, J.) (curtailment of mutuality doctrine ''washed away the foundation on which the edifice of Rule 23 had been built'').