

October 8, 2007

Continuing Recent Trend, Court Dismisses Securities Fraud Claims Brought Against Foreign Issuer on Subject Matter Jurisdiction Grounds

In a decision rendered on September 26, 2007¹, Judge Deborah A. Batts of the United States District Court for the Southern District of New York dismissed a putative class action brought against the French chemicals company, Rhodia, S.A., and certain of its current and former officers and directors on the ground that the Court did not have subject matter jurisdiction over the dispute.² The suit, initiated by two foreign investment funds, was brought under U.S. securities laws on behalf of a class of foreign investors who had bought Rhodia's shares overseas on the Paris Euronext between April 2001 and March 2004. In particular, the foreign plaintiffs alleged that Rhodia had fraudulently inflated the value of Rhodia's Euronext shares through a series of alleged misrepresentations about the Company's financial results. Significantly, Judge Batt's ruling marks the continuation of a recent trend whereby federal courts have declined to exercise subject matter jurisdiction over claims asserted by foreign investors against foreign companies for alleged violations of the U.S. securities law in which the conduct at issue took place primarily outside of the United States.

As the Court initially recognized, while U.S. securities law does not explicitly define when its provisions apply extraterritorially, the U.S. courts have developed two tests – the “conduct test” and the “effects test” – to determine when the exercise of subject matter jurisdiction over foreign securities claims is proper. As their names suggest, the “conduct test” looks for evidence of sufficient wrongful conduct within the United States to establish jurisdiction, while the “effects test” looks to whether the misconduct outside of the United States had a substantial effect on United States investors and/or American securities markets. Because the “effects test” only is meant to shield domestic investors and domestic markets from the effects of securities frauds perpetrated elsewhere, the Court quickly concluded that the “effects test” could not be satisfied by foreign investors who purchased shares of Rhodia, a foreign company, on a foreign exchange.

Turning next to the “conduct test,” the Court explained that, under well-established law, the federal securities laws will apply extraterritorially only if “(1) the defendant's activities in the United States were more than merely preparatory to a securities fraud conducted elsewhere, . . .

¹ *In re Rhodia S.A. Securities Litigation*, No. 1:05 Civ. 5389 (DAB) (S.D.N.Y. Sept. 26, 2007).

² Paul, Weiss, Rifkind, Wharton & Garrison LLP represented Rhodia and several of its officers and directors.

1285 Avenue of the Americas
New York, New York 10019-6064
(212) 373-3000

Fukoku Seimei Building 2nd Floor
2-2, Uchisawaicho 2-chome
Chiyoda-ku, Tokyo 100-001, Japan
(81-3) 3597-8101

1615 L Street, NW
Washington, DC 20036-5694
(202) 223-7300

Unit 3601, Fortune Plaza Office Tower A
No. 7 Dong Sanhuan Zhonglu
Chao Yang District, Beijing 100020
People's Republic of China
(86-10) 5828-6300

Alder Castle, 10 Noble Street
London EC2V 7JU England
(44-20) 7367 1600

12th Fl., Hong Kong Club Building
3A Chater Road, Central
Hong Kong
(852) 2536-9933

and (2) these activities or culpable failures to act within the United States directly caused the claimed losses.” The foreign plaintiffs tried to convince the Court that they had met this threshold insofar as certain of the misstatements related to (i) projections concerning the acquisition of ChiRex Inc., a United States company, (ii) environmental liabilities concerning a plant owned by Rhodia in Montana. Additionally, the foreign plaintiffs also pointed to the fact that the misstatements appeared as part of Rhodia’s regulatory filings under the United States securities laws.

Ultimately, however, the Court rejected these arguments as having no merit. Judge Batts began her analysis by finding that the foreign plaintiffs had failed to satisfy the first prong of the “conducts test” – that is, showing that the acts at issue in the case were “more than merely preparatory acts of a securities fraud conducted elsewhere.” As the Court explained in this regard, the activities that plaintiffs claimed were fraudulent were not themselves acts of securities fraud. A Section 10(b) claim only arises if the corporate issuer makes a materially false or misleading statement to an investor who makes an actual purchase or sale of Rhodia’s securities in reliance on that statement. Because all of the alleged misstatements about both the projections related to ChiRex, Inc. and Rhodia’s U.S. environmental liabilities were made by Rhodia’s officers and directors abroad (in France), and not here in the United States, the Court ruled the “conduct test” could not be satisfied.

The Court also held, even were that not the case, the foreign plaintiffs could not satisfy the second prong of the “conduct test” because none of the alleged misstatements “directly caused” their losses. The Court observed that the foreign plaintiffs’ own allegations made it clear that Rhodia’s “American activities were neither significant in light of the global scope of their business, nor can they be said to have been a direct cause of the plaintiffs’ losses.” Because the inaccurate ChiRex, Inc. projections and misstatements about Rhodia’s U.S. environmental liabilities could not therefore have themselves directly caused the losses, the Court found that it did not have subject matter jurisdiction over the claims for this additional reason as well.

Finally, the Court also rejected the foreign plaintiffs’ allegations that the false and misleading statements were published in Rhodia’s SEC filings were, by themselves, enough to confer subject matter jurisdiction over the claims made by those who purchased Rhodia’s shares on the Euronext. After noting that “Rhodia’s filing of SEC reports were conceived, engineered, and published on foreign soil,” the Court concluded that it was well-established that the SEC filings, alone, are insufficient to trigger this Court’s subject matter jurisdiction.” Holding that the “conducts test” could thus not be satisfied by any of the foreign plaintiffs’ allegations, the Court ruled that there was no subject matter jurisdiction over the foreign investors’ securities law claims. Accordingly, the Court dismissed these claims with prejudice, finding that, given the predominately foreign conduct at issue, it would be “futile” to even allow the foreign plaintiffs another attempt at repleading their securities law claim.

As Judge Batts noted in her opinion, Congress simply did not intend the “United States courts to adjudicate entirely foreign disputes involving foreign investors and their securities in foreign corporations traded on foreign markets.” With Judge Batt’s decision, which is only the latest in a series of recent decisions by courts dismissing securities fraud claims brought by foreign investors for purchases made on foreign exchanges, foreign corporations should draw some comfort that, under certain circumstances, they will not ultimately be forced to litigate such claims here in the United States.

* * *

This memorandum is not intended to provide legal advice with respect to any particular situation, and no legal or business decision should be based solely on its content. Questions concerning issues addressed in this memorandum should be directed to:

Martin Flumenbaum	(212) 373-3191
Andrew G. Gordon	(212) 373-3543
Maria T. Vullo	(212) 373-3346